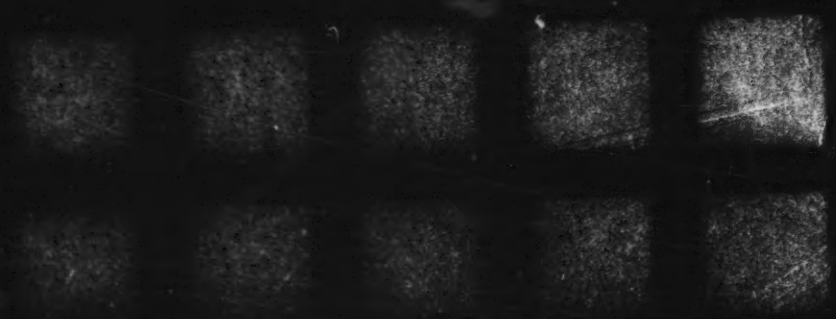
QUÉBEC'S PUBLIC FINANCES

The Need for Immediate Action

Preliminary budget document, published March 5, 1986, by Gérard D. Levesque, minister of Finance.



Québec

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Gouvernement du Québec
Ministère des Finances

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FOREWORD

It is imperative for any new government to get a clear picture of the economic and financial situation confronting it in order to draw up the policies it intends to propose to the people. This is the purpose of this paper.

The observations we had to make are particularly worrying, both because of the extent of the problems, often unsuspected, that they highlight and of the difficulty of finding responsible solutions.

When we opened the government books, we found, for the coming fiscal year (1986-1987), an unacceptable gap of $1.3 billion in addition to the nearly $3 billion deficit that had been announced in the Budget Speech of last April.

Budgetary deficits of some $3 billion, incurred repeatedly over the past five years, have caused Québec's state of indebtedness to rise to a point where 13.6 % of government revenue is needed to assume interest charges on the debt, without reducing the principal; for several years the government has even borrowed to finance a portion of its current expenses, that is to say, "to pay the grocery bill".

The gravity of this problem can be explained in part by the inordinate growth of recurrent government expenditures, especially if we compare them with those in Ontario. If we adjust the gross expenditures of the two governments in order to compare them, we see that Québec's public services cost close to $5 billion more than those of Ontario.

In addition, taxation in Québec is heavier than in Ontario, investment is too low and the present level of employment, despite the immense potential of our economy, is clearly inadequate.

That, briefly, is the situation we have inherited!

With a view to demystifying and simplifying the budgetary process, we feel it is essential, less than three months after the formation of the new government, to inform the people about what we have found, in order to make them aware of the nature of the problems confronting it.

We have got to stop living beyond our means.

We are convinced that the performance of our economy will eventually help restore our public finances to a healthier state. In the short term, however, it would be irresponsible to allow the deficit to increase, or even to stay at its present level for long. The mounting deficit is the source of our increased indebtedness and, consequently, of the impossibility of obtaining any financial leeway. An increase in income taxes must only be envisaged as a last resort. Instead, to improve the competitive nature of the Québec economy we have to reduce the tax burden. We must therefore seek our solution in a substantial decrease in unproductive expenditure, without losing sight of the possible negative effects of such budget cuts.

This situation makes budgetary choices and solutions a very delicate matter this year.

Gérard D. Levesque
Minister of Finance

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I. QUÉBEC'S PUBLIC FINANCES: THE NEED FOR IMMEDIATE ACTION.

In his last Budget Speech of April 1985, the Minister of Finance of the previous government presented the government's financial forecasts for 1986-1987 and 1987-1988. A significant growth in budgetary revenue was anticipated — close to 6 % a year — despite the tax reductions announced for 1986-1987 and 1987-1988 and the levelling-off of federal transfers for the first year. At the same time, it was forecast that budgetary expenditure would rise by about 4.5 % a year, barely keeping up with inflation. The government's financial position was therefore viewed as being in a relatively good state of repair; it was even forecast that the budgetary deficit would drop to under $3.0 billion in 1986-1987. Given anticipated economic growth, both the deficit and the net financial requirements as a percentage of GDP were to decrease.

A gap of $1.3 billion

The day after the December 2 elections, when the new government opened the books, the prospects proved to be totally different. The deficit forecast for 1986-1987 was $1.3 billion more than the figure given in the April 1985 Budget Speech.

Table I.1
GOUVERNEMENT DU QUÉBEC
SUMMARY OF FINANCIAL TRANSACTIONS
(in millions of dollars)

	1984-1985	1985-1986		1986-1987	
	Real	Budget Speech (April 1985)	Quarterly Presentation of Financial Transactions at September 30, 1985	Budget Speech (April 1985)	November 1985
Budgetary revenue	+22 310	+24 155	+24 015	+25 520	+25 269
Budgetary expenditure	−25 543	−27 250	−27 250	−28 490	−29 531
Deficit	− 3 233	− 3 095	− 3 235	− 2 970	− 4 262
Balance of non-budgetary transactions	+ 1 231	+ 1 495	+ 1 450	+ 1 405	+ 1 278
Net financial requirements	− 2 002	− 1 600	− 1 785	− 1 565	− 2 984

Note: A (+) sign indicates a source of financing and a (−) sign, a financial requirement.

It will be possible, by acting with determination, to balance the books for 1985-1986 at close to the level forecast, but obviously immediate action is required in the coming fiscal period in order to prevent the budgetary deficit from soaring from the anticipated level of close to $3 billion to $4 billion in 1986-1987 and staying at this point in the years to come.

Table I.2 shows the main changes made in the financial framework during the past few months.

Forecast for 1986-1987 void by the end of May 1985

The estimated budgetary expenditure for 1986-1987 presented in the April 1985 Budget Speech had to be revised upwards by some $753 million at the end of May; anticipated budgetary cuts amounting to $85 million in cuts were abandoned, there were additional expenditures of $78 million, a reinstatement of the $52 million budget base, but the main portion was an increase in the cost of $538 million for existing programs, particularly in the realm of health and income support. Moreover,

Table I.2
Change in the deficit in comparison with the three-year forecast of the April 1985 Budget Speech
(in millions of dollars)

	1986-1987 Fiscal Year			
	April 23, 1985 Budget	Revision of end of May 1985	Revision of November 1985	After the Budgetary and Financial Policy Statement December 1985
Own-source revenue				
• Decrease in Hydro-Québec dividends	—	—	240	240
• Cost of reconciliation with the federal budget	—	54	54	54
• Increase following revision of economic forecasts	—	—	−224	−224
• Non-privatization of SAQ	—	—	—	50
• Impact of the Budgetary and Financial Policy Statement	—	—	—	169
TOTAL	**—**	**54**	**70**	**289**
Federal transfers				
• Reduction in equalization payments resulting mainly from revised economic forecasts	—	—	119	119
• Drop in payments following premature reopening of fiscal arrangements (health and education)	—	—	82	82
• Other	—	—	− 20	− 20
TOTAL	**—**	**—**	**181**	**181**
Budgetary expenditure				
— Increase in expenditure resulting from:				
• recurrence of cuts not made in 1985-1986	—	85	85	85
• minimum reserve to take account of additional financial problems	—	—	150	150
• further decisions in 1985-1986	—	78	136	136
• reinstatement of the budget base of hospital centres	—	52	100	100
• revision of costs of existing programs*	—	538	467	461
• **Subtotal**	—	753	938	932
— Revision of economic forecasts				
— (inflation, interest rates)...	—	—	−252	−252
— Cuts anticipated but not identified	—	455	355	355
TOTAL		**1 208**	**1 041**	**1 035**
GRAND TOTAL: change in deficit since April 23	**—**	**1 262**	**1 292**	**1 505**
Anticipated deficit	2 970	4 232	4 262	4 475

* Includes increases in clienteles and in volumes.

Note: A (+) sign indicates an increase in deficit and a (−) sign, a decrease.

reconciliation with the federal budget submitted on May 23, 1985, represented an expenditure of $54 million for Québec.

In addition, when we consider that the forecasts in the April 23, 1985, Budget Speech incorporated cuts totalling $455 million in 1986-1987, without establishing any specific plan for making them, it is clear that the financial framework on which this budget was based had become null and void a bare week or two after it was presented in the National Assembly.

Review of November 1985

Last fall, as usually happens at this time of the year, the ministère des Finances, in collaboration with the secrétariat du Conseil du trésor, undertook a complete review of economic prospects and financial balances. The results of this review for 1986-1987 were established in early November.

As the preceding table shows, this revision of economic forecasts made it possible to decrease anticipated expenditures by $252 million and to increase own-source revenue by $224 million; however, this contributed to a drop in equalization payments amounting to $119 million. After the publication of the Quarterly Presentation of Financial Transactions in September 1985, anticipated Hydro-Québec dividends disappeared, primarily because of the fall of the Canadian dollar, which had just eaten up this Crown corporation's expected earnings; the $131 million in dividends anticipated for 1985-1986 disappeared, while those expected for 1986-1987 fell by $240 million, from $521 to $281 million. In addition, last year the federal government announced its intention of reducing transfers to the provinces for health and post-secondary education, resulting in a loss of $82 million in 1986-1987 for Québec. Finally, the non-indexation of certain operating expenditures made it possible to identify $100 million of the $455 million in anticipated cuts, while further government decisions had increased forecast expenditures by $58 million, and the amounts necessary for reinstating the budget base for hospital centres rose from $52 million to $100 million.

Assumptions and additional financial problems

The 1986-1987 forecasts offered all kinds of suppositions. With regard to own-source revenue, the financial framework provided for an increase in charges for goods and services furnished by the Québec government, for an amount of $60 million. In addition, it provided for an accounting reform to incorporate into government revenue all of Hydro-Québec's net profits. Finally, forecasts included revenue recovery amounting to $76 million, including $45 million in sales tax, $20 million in increased fines under the Highway Safety Code, and $11 million from additional recovery operation, particularly at the ministère du Revenu.

The new government inherited three additional financial problems that were known, but which will have to be dealt with in the coming Budget Speech: the operating deficits accumulated by hospital centres since 1982-1983, the condition of accounts receivable, particularly at the ministère du Revenu, and the losses incurred with regard to some Crown corporations.

In the case of hospital centre operating deficits, an amount of $100 million has been added to expenditures for 1986-1987 to ensure that the same thing does not happen this fiscal period. But nothing has yet been set aside to amortize the deficits accumulated since 1982-1983, which total $260 million at present.

The level of bad debts now stands at over $600 million, $532 million at the ministère du Revenu alone. It will be necessary to account for them in some way or other eventually, even if it has to be gradually.

We must finally stress the fact that there was no reserve included in the estimated expenditure for the capital costs of $195 million for the acquisition of the Société nationale de l'amiante mining subsidiaries, which continue to operate at a loss, or for the amortization of loans of $320 million that Sidbec had to assume as part of the Sidbec-Normines Inc. operations and the shutdown of its

activities at Gagnon. In addition, the situation of a number of other Crown corporations indicates the need for additional investments or the write-off of assets in the immediate or near future.

After including $150 million to take these additional financial problems into account, the budgetary deficit forecast for 1986-1987 exceeds by $1.3 billion the $3.0 billion forecast last April.

Such was the situation the government inherited for 1986-1987.

It must be remembered that all these figures were established without considering the changes in accounting practices which could eventually be adopted following the comments of the Auditor-General about the government's financial statements; these comments are now being studied at the ministère des Finances.

The Budgetary and Financial Policy Statement of December 18, 1985

Despite this situation, in order to restore the confidence of economic agents, stimulate economic growth and promote job creation, the Budgetary and Financial Policy Statement of last December introduced fiscal measures reducing personal income tax, the tax on fuel and the tax on insurance. This was made possible in 1985-1986 by taking administrative measures and vigorous steps to curb expenditures, which brought about a decrease in the deficit for the 1985-1986 fiscal year as compared with that forecast before the Statement. As for the anticipated 1986-1987 deficit, it would stand at $4.5 billion if no corrective measures were applied.

The need for immediate action

We cannot allow the deficit to remain at such a level. Not only would an increase in a deficit of this magnitude be totally unjustifiable in a period of economic expansion, but it would make Québec extremely vulnerable at the slightest sign of any slowdown in the economy. The increase in the debt service accompanying any rise in the deficit would result in a further bite into total government expenditure. The adjustments that would eventually have to be made would be that much more fierce.

We must remember that the government's financial position is examined periodically by credit rating agencies which, acting somewhat in the manner of physicians who know the state of health of their patients, pass judgment on the quality of the government's credit. The government, to continue to have access to financial markets on relatively attractive terms, must bear in mind the perspective from which credit rating agencies analyse its financial position. It seems clear that a deficit of the size forecast for 1986-1987 prior to corrective action would lead to a reduction in Québec's credit rating and, consequently, an increase in its borrowing costs.

It is therefore clear that the need to launch recovery measures with regard to the budgetary deficit is urgent. These measures must be carried out in as ordered and responsible a manner as possible.

Since Québec's budget more than ever contains decisions that closely affect the lives of the people, the public must be kept informed of the state of the public finances in an open, objective manner. Quebecers will in this way be intimately associated with the major economic, budgetary and fiscal policies that determine their future.

This is the purpose of this paper. It is designed, first of all, to allow us all to learn from the past and to define the present situation, to decide just how we came to such a pass and in what ways the present situation is unacceptable. Then we must go on to find ways of setting things right and establish principles for the sound management of public finances.

II. THE STATE OF THE ECONOMY: UNDER-EMPLOYMENT AND UNDER-INVESTMENT

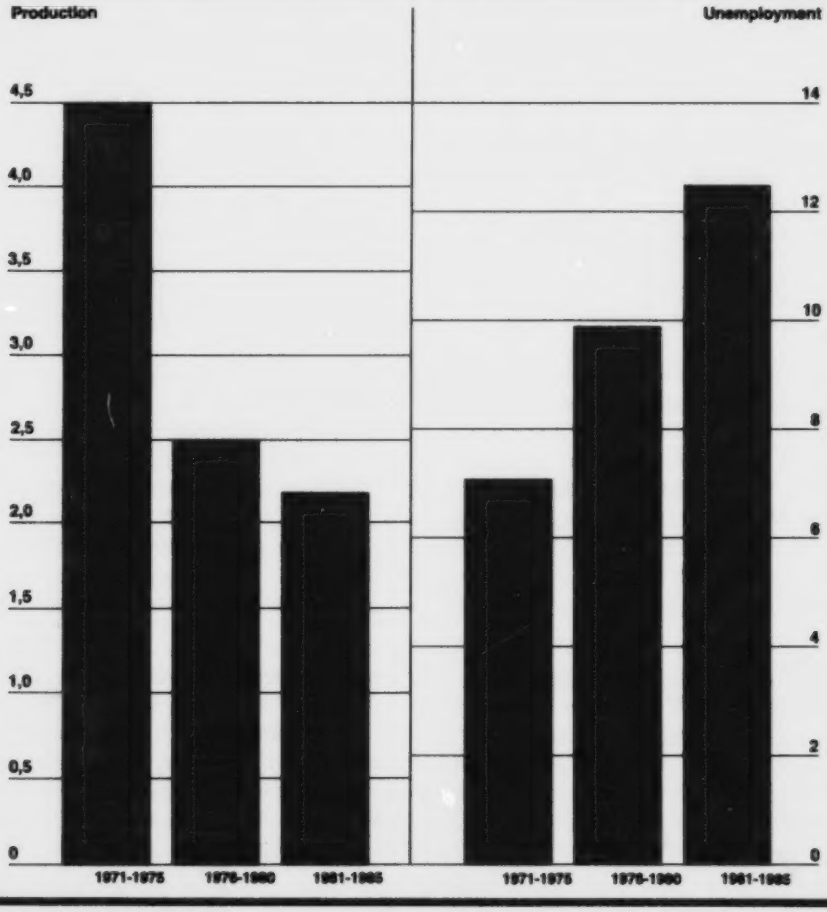
It is impossible to broach the question of public finances without dealing with the state of the economy. It is the economy that supports public finances and determines their equilibrium and evolution. And public finances in turn profoundly influence the state of the economy. Forty years ago the expenditures of the provincial administration represented only 4 percent of domestic production; today the figure is over 25 percent. It is for this reason that, before squarely confronting the financial situation, we give a brief overview of the state of the Québec economy, in order to pinpoint its strengths and weaknesses and their connection with public finances.

Québec's economy is modern, diversified and highly industrialized. The standard of living of its citizens still holds an enviable position internationally. The abundance of its natural resources and its wealth of human capital, as well as its location in the heart of the most highly industrialized continent gives it undeniable advantages. However, in the past few years Québec's economic performance has been very much below its potential and insufficient to meet the legitimate expectations of its citizens. The growing discrepancy between the performance and potential of the economy has curbed progress in the standard of living and resulted in an unacceptable level of unemployment.

Economic growth began to slow down in industrialized countries in the mid-1970s, after the first oil crisis. Since then the world economy has suffered economic fluctuations and upsets of a scope that has nothing in common with the adjustments of the preceding 25 years. Suffice it to recall the quadrupling of crude oil prices in 1973 and the further increases in 1979-1980, the inflationary pressures and the economic policies that resulted, the recession of 1982, the adaptation costs incurred by many industrial sectors as a result of the lowering of the tariff barriers negotiated under the GATT agreements, and the stiff competition of countries with poorly paid labour forces.

Graph II.1
PRODUCTION GROWTH AND UNEMPLOYMENT
QUÉBEC

(as a percentage)



Source: Conference Board of Canada
Labour Force Survey, S.C., 71-001.

Québec, with its very open economy, has not escaped the effects of these development. Between 1970 and 1980, growth in production dropped. The problems encountered by Québec were shared to a certain extent by the majority of industrialized countries; in production, investment and employment Québec in the 1970s compared fairly well with these countries.

The international situation had repercussions not only in Québec, but in the Canadian economy as a whole. In this respect the relative performance of Québec was somewhat mitigated. The increase in production in Québec, although lower than the Canadian average, was much the same as in Ontario up to 1980, and during this same period Québec recorded greater gains in labour productivity than did Ontario. On the other hand, for the period 1981 to 1985, the situation in Québec was less favourable than that in Ontario. Finally, it was above all in the realm of private investment that trends are disquieting.

Table II.1
MAIN ECONOMIC INDICATORS
QUÉBEC, ONTARIO, CANADA
(percentage change)

	1971-1975			1976-1980			1981-1985[1]		
	Québec	Ontario	Canada	Québec	Ontario	Canada	Québec	Ontario	Canada
Real domestic product	4.5	4.7	5.0	2.5	2.3	3.3	2.2	3.1	2.1
Productivity	1.8	1.4	1.8	0.4	−0.2	0.4	1.3	1.4	1.0
Labour force	3.0	3.7	3.5	2.5	2.6	3.0	1.3	1.9	1.8
Employment	2.7	3.3	3.2	2.1	2.5	2.9	0.9	1.7	1.1
Unemployment[2]	7.2	5.1	6.0	9.9	6.7	7.7	12.5	8.8	10.4
Non-residential private investments									
• in volume	11.9	4.4	5.9	−0.9	3.2	5.9	1.5	1.3	−1.1
• as a percentage of GDP	9.1	9.4	10.7	7.6	9.1	10.8	7.2	8.8	10.4

1 Forecasts for 1985.

2 Level in %.

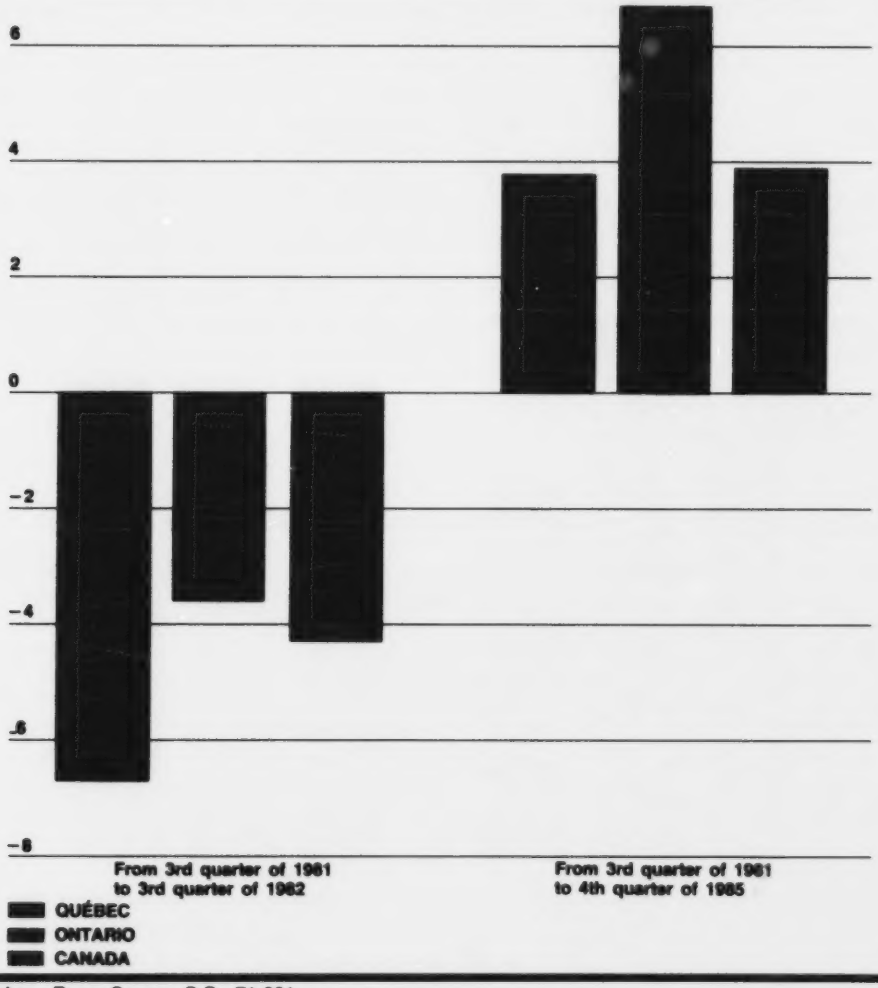
Source: Statistics Canada
Conference Board of Canada.

(a) Unsatisfactory performance since the beginning of the decade

During the 1982 recession, output in Québec dropped by more than 7 %. Between the fall of 1982, the beginning of the recovery, and the end of 1985, most industrialized sectors recovered the losses suffered during the recession; the real domestic product exceeded by 8.5 % the peak reached in the second quarter of 1981. But two sizable exceptions are to be noted. First, the mining sector where structural changes were so vast that output is now close to 25 % below its last peak. Second, the manufacturing sector, which did not completely succeed in making good the losses incurred during the recession until the final quarter, because of the unfavourable effects of the structural decline in the textile, clothing, leather, petrochemical and oil refining industries.

Graph II.2
EVOLUTION OF EMPLOYMENT IN QUÉBEC, ONTARIO AND CANADA

(as a percentage)



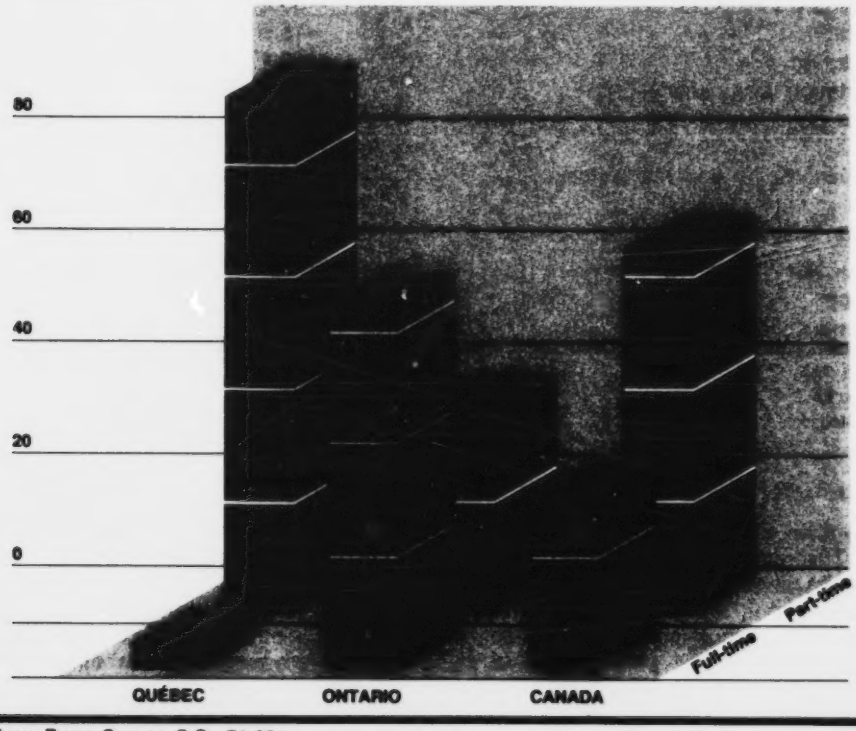
Source: Labour Force Survey, S.C., 71-001.

During the four quarters of the recession, 185 000 jobs were lost. Recovery in production was accompanied notably by a streamlining of production processes in many industries, and large gains in productivity were recorded. In terms of jobs, even though the losses resulting from the recession were cancelled out at the end of 1984, recovery was very modest, particularly when compared with results in Ontario.

Québec's recovery appears more modest still when we consider that, of a total of 105 000 additional jobs since the peak of 1981, 100 000 were part-time.[1] Compared with Ontario and the whole of Canada, the scarcity of new full-time jobs is a special problem in Québec.

This unfavourable situation with regard to employment must be considered along with job losses in several sectors — mines, manufacturing, transportation, communications and public utilities; 1985 ended with a level of employment lower than that of the summer of 1981, more than four years

Graph II.3
FULL-TIME AND PART-TIME JOBS CREATED AS A PERCENTAGE OF TOTAL JOB CREATION (1981: 3 TO 1985: 4)



Source: Labour Force Survey, S.C., 71-001.

earlier. Therefore, Québec has recovered in number but not in quality the jobs lost during the crisis. Full-time positions have been replaced by part-time, and well paid jobs in the primary sector and the manufacturing industries have been replaced by less lucrative work in trade and the services sector.

1 Full-time workers work 30 hours or more per week, while part-time workers work less than 30 hours per week.

Table II.2
EVOLUTION OF EMPLOYMENT IN QUÉBEC DURING THE RECESSION AND THE RECOVERY COMPARED TO THE LAST PEAK (1981:3)[1]

	Losses during recession %	Position in comparison with last peak*		
		1984: 4*[1]	1985: 4*[1]	Job creation (in thousands)
Agriculture	− 5.5	95.5	106.7	5
Other primary industries	−30.2	88.4	82.0	− 10
Construction	−15.9	96.8	100.0	0
Manufacturing	−10.1	93.6	92.7	− 43
Transportation, communications and other public utilities	− 5.4	88.4	97.9	− 5
Trade	− 5.8	106.3	105.9	28
Finance, insurance and real estate	−13.6	101.1	107.3	10
Services	− 0.1	106.5	114.5	121
Public administration	−10.7	94.4	99.3	− 1
Total Québec	**− 6.7**	**99.8**	**103.8**	**105**
Full-time	− 8.4	97.1	100.1	5
Part-time	6.5	121.5	133.4	100

1 Quarterly data.
* Peak equals 100.
Source: Statistics Canada.

(b) Structural decline or industrial transformation?

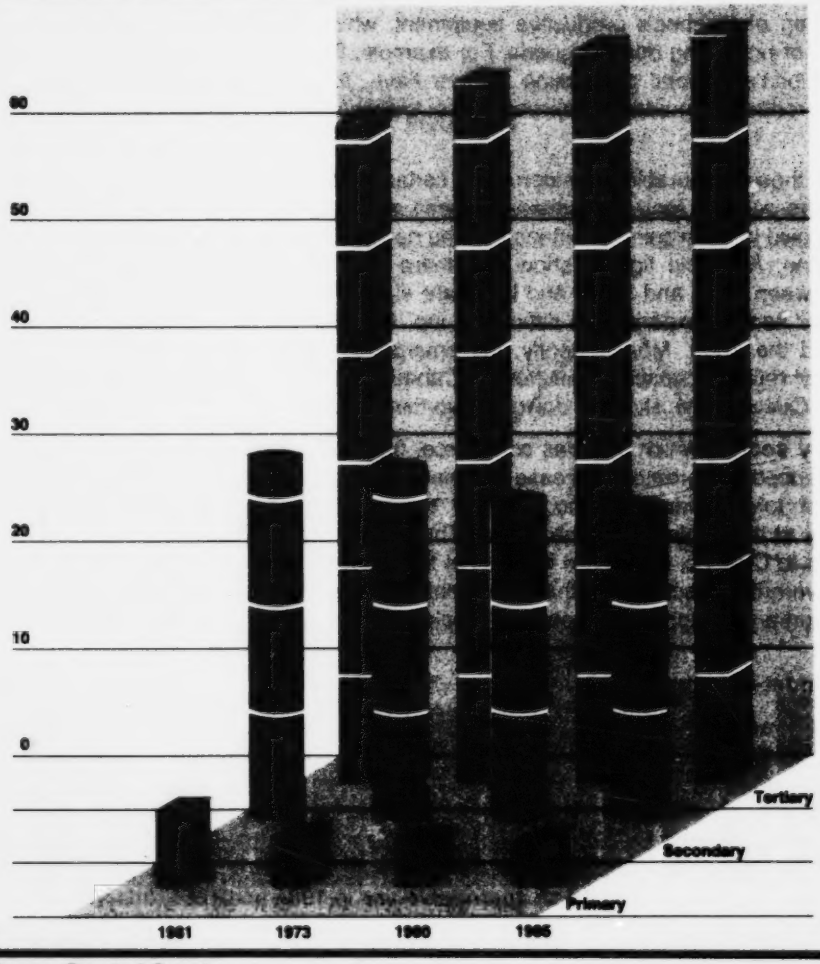
The slowdown in economic growth has been accompanied by profound structural changes in Québec. The main shortcomings in the industrial structure and the basic obstacles in the way of development have had a great impact, particularly since the early 1980s. The chronic weakness of private investment, the problems stemming from deficiencies in the competitive nature of certain industries in the manufacturing sector, especially the textile, clothing and shoe industries, have had a decisive effect on the performance of the province's economy. On the other hand, greater penetration of foreign markets because of new, competitive industries oriented towards outside markets as well as the development of hydroelectric potential are factors that have helped growth in Québec.

Modification of the industrial structure

The present structure of Québec's economy is the result of many factors that have marked its development over the years, including demographic trends, the international situation, government economic policies and the reactions of individuals and business firms to these factors, as well as the reorganization now going on in a number of industries. These structural developments, that have marked the economic scene, have made themselves felt in varying degrees in the industrial sectors.

The primary sector, which includes agriculture, forestry, fishing and mining, represents no more than 2.9 % of total production and less than 5 % of employment. This is mainly caused by the shrinking of the mining sector by 50 % over the past 15 years; it now accounts for only 0.7 % of production. Apart from precious metals, which enjoyed a rise in prices in the 1970s, the setback in production affects most of the major products, such as asbestos, iron and ordinary metals, zinc and copper for example, the output of which dropped by over 50 % between 1971 and 1984. Important factors in these changes were the international campaigns to discourage the use of asbestos, the

Graph II.4
QUÉBEC INDUSTRIAL STRUCTURE
(as a percentage of real production)



Source: Conference Board of Canada.

decline of copper mining reserves in Québec, extremely lively international competition and the low prices which resulted, the loss of competitiveness of the U.S. steel industry and the resulting weak demand for Québec iron ore, the emergence of new metal producers, particularly in the iron industry, and the increased movement towards recycling of metals.

The secondary sector, including the manufacturing industries and construction, accounted for 25.1 % of employment and 27.8 % of production in 1984. Trends observed in the manufacturing sector over the past 15 years are mixed. In many respects the changes that have occurred are encouraging. First, the sector has succeeded in increasing its labour productivity by rationalizing its operations, with the result that the spread with Ontario has been reduced by close to 60 %. Second, the industry has appreciably expanded its outlets on foreign markets, so that today over 26 % of shipments are exported as against 19 % in 1973. This was a remarkable achievement considering the relatively unfavourable international situation, and it came about because of the drop in the

Canadian dollar and the dynamism of exporters of new products, such as electronic tubes and semi-conductors, aeronautics, telecommunications and road transport equipment and furnishings and fixed appliances.

Finally, the vitality of many business firms should be mentioned, for this contributed to the modernization of Québec's productive equipment, which in many cases accentuated the relative importance of producing durable goods. For example, firms in the transport equipment, machinery, wood, and primary metal processing sectors have, through their investments and the resulting increased production, made an appreciable contribution to the progress of the entire manufacturing sector.

As against these favourable developments, certain industries have had to face difficulties. Traditional sectors such as leather, textiles, knitwear and clothing, that are unable to compete with the low wages paid in developing countries and the newly industrialized nations of Asia, have suffered a sharp decline. Available figures show that there was a loss of more than 24 000 jobs in these sectors between 1973 and 1980, and there are signs that the downward movement has continued since. Other sectors experienced difficulties too. Québec lost part of its petrochemical industry to Ontario and the West. More recently, the emergence of surplus oil products, resulting from the expansion of refinery capacity elsewhere in Canada and the pronounced slowdown in demand, has meant, for Québec, the shutting down of two-thirds of its refineries within three years.

The tertiary sector, which includes commerce, finance, commercial services and public services, has experienced the greatest increase in employment and production. Today this sector accounts for 69 % of total production and 70 % of total employment, compared with 61 % and 52 % respectively at the beginning of the 1960s. This movement towards tertiary concentration, which is not peculiar to Québec, was given impetus at the outset by the very rapid growth of public services and the government sector. Now that the catching-up process has been completed, it is obvious that growth in tertiary sector production and employment must now come from elsewhere.

Chronic under-investment

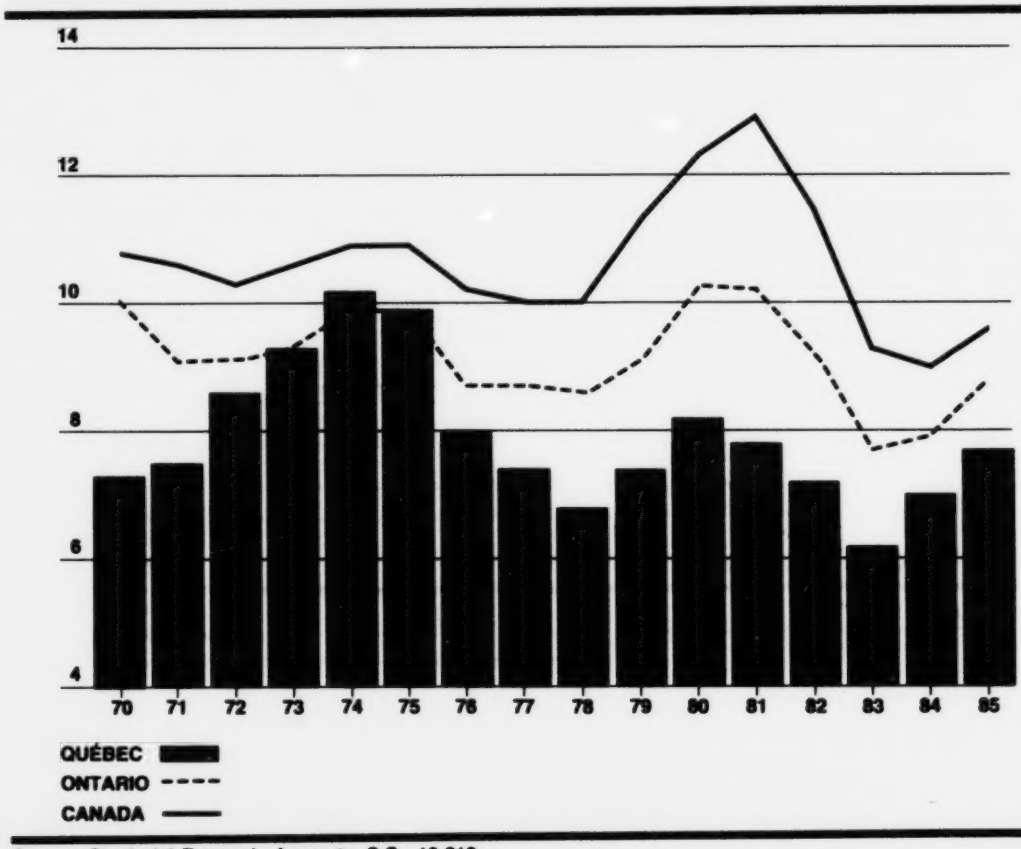
The rate of investment, that is to say, the portion of the Gross Domestic Product (GDP) devoted to gross capital investment, is one of the main indicators of economic health. In this regard, Québec's performance is not especially something to rejoice about. Whereas for all the OECD countries this rate varies between 20 % and 22 %, and for countries enjoying rapid growth rates between 25 % and 30 % and even more are not uncommon — Japan, for example, had an investment rate of 30 % for 30 years — the Québec rate has been higher than 20 % for only four years (1974-1977) in the past 20 years. At present, despite an appreciable rise in 1984 and 1985, this rate still stands at only 17 %. It is no great comfort that the performance of the United States and Ontario has not been much better. Per capita investment in Canadian dollars was $3 490 in the United States, $3 125 in Canada as a whole, $2 925 in Ontario and $2 500 in Québec. It is clear that in the matter of investment, Québec is closer to the end of the queue than to its head. Although unemployment and under-employment remain our most visible problems, chronic under-investment is certainly one of the main causes.

Part of the decrease in the rate of investment in Québec's economy over the past decade is attributable to firms in the public sector, particularly Hydro-Québec, whose capital expenditures have dropped since 1978, as the James Bay projects were being carried out.

However, the most significant factor is the inadequacy of private capital investment. The rate of investment in the private sector fell from 9.9 % in 1975 to 7.7 % in 1985. This problem is accentuated following a cyclical drop in demand. There are other, more difficult factors to be

grasped, but fully as important, such as the exodus of head offices, inadequate capitalization of business firms, the effects of high interest rates on small and medium-sized businesses, an uncompetitive taxation system, and government regulations that are sometimes restrictive. These have also been contributory factors in the insufficiency of private investment in Québec.

Graph II.5
NON-RESIDENTIAL PRIVATE INVESTMENTS
AS A PERCENTAGE OF GROSS DOMESTIC PRODUCT
QUÉBEC, ONTARIO AND CANADA



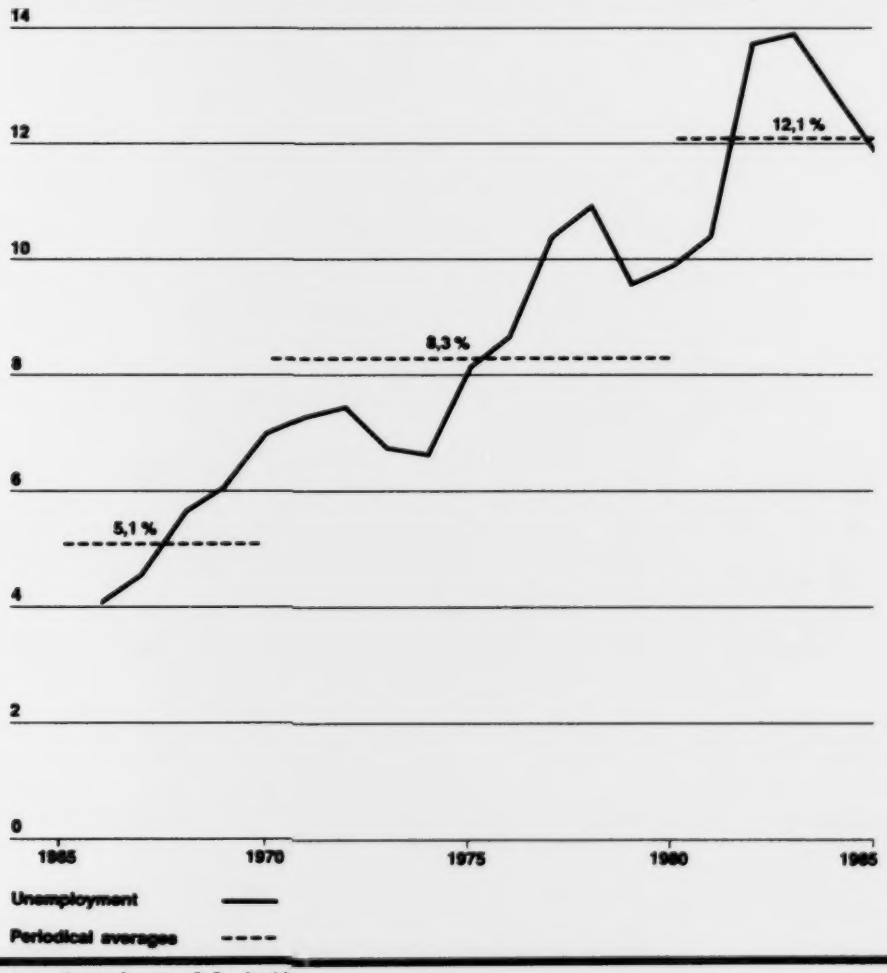
Source: Provincial Economic Accounts, S.C., 13-213.
Private and Public Investment in Canada, S.C., 61-205.

Unemployment and under-employment: an unacceptable situation

The unemployment rate in Québec has increased since 1966, the average going up systematically from one decade to the next. In 1985, there were 376 000 unemployed persons or a rate of 11.8 %, 13.5 % more than in 1981.

Graph II.6
UNEMPLOYMENT RATE IN QUÉBEC

(as a percentage)



Source: Labour Force Survey, S.C., 71-001.

To measure the extent to which the problem of unemployment has been exacerbated over the past ten years, we only need consider that, compared with 1976, when the unemployment rate was 8.7 %, the number of unemployed increased by 143 000. Even though the jump affected all categories of workers, the burden of the rise in unemployment fell on those between 25 and 34 and

those over 55. Despite an appreciable reduction in the demographic preponderance of young people, their rate of unemployment escalated to an unaceptable level because of the resulting personal and social costs.

The rise in unemployment is generally accompanied by longer periods of unemployment, which tends to discourage workers in their search for jobs, which are becoming few and far between. This situation goes a long way towards explaining the very considerable rise in social aid recipients able to work in the past few years in Québec. Since 1976, their number has tripled, so that today over 70 % of heads of households receiving social aid are considered able to work. It is especially disturbing to think that this high level continued well beyond the crisis; since the beginning of recovery, i.e. the fall of 1982 up to the fourth quarter of 1985, numbers have risen from 221 486 to 298 542, an increase of 34.8 %. Since this phenomenon means a transfer of the financial burden of income support from unemployment insurance (federal funds) to social aid (shared funds), it has considerable consequences for Québec's public finances.

Table II.3
EVOLUTION OF UNEMPLOYMENT IN QUÉBEC
1976-1985

	Unemployment rate (%)		Unemployed (thousands)		
	1976	1985	1976	1985	Change
15 to 24-year-olds	15.5	18.1	113	126	13
25 to 34-year-olds	7.1	12.4	53	118	65
35 to 44-year-olds	5.7	8.6	29	65	36
45 to 54-year-olds	5.7	8.5	25	40	15
55 to 64-year-olds	5.4	10.3	13	27	14
Total	**8.7**	**11.8**	**233**	**376**	**143**
Households receiving social aid whose head is able to work	—	—	92	286*	194

* Preliminary data.

Source: Statistics Canada
Ministère de la Main d'oeuvre et de la Sécurité du revenu.

III. THE EVOLUTION OF THE FINANCIAL FRAMEWORK IN RECENT YEARS

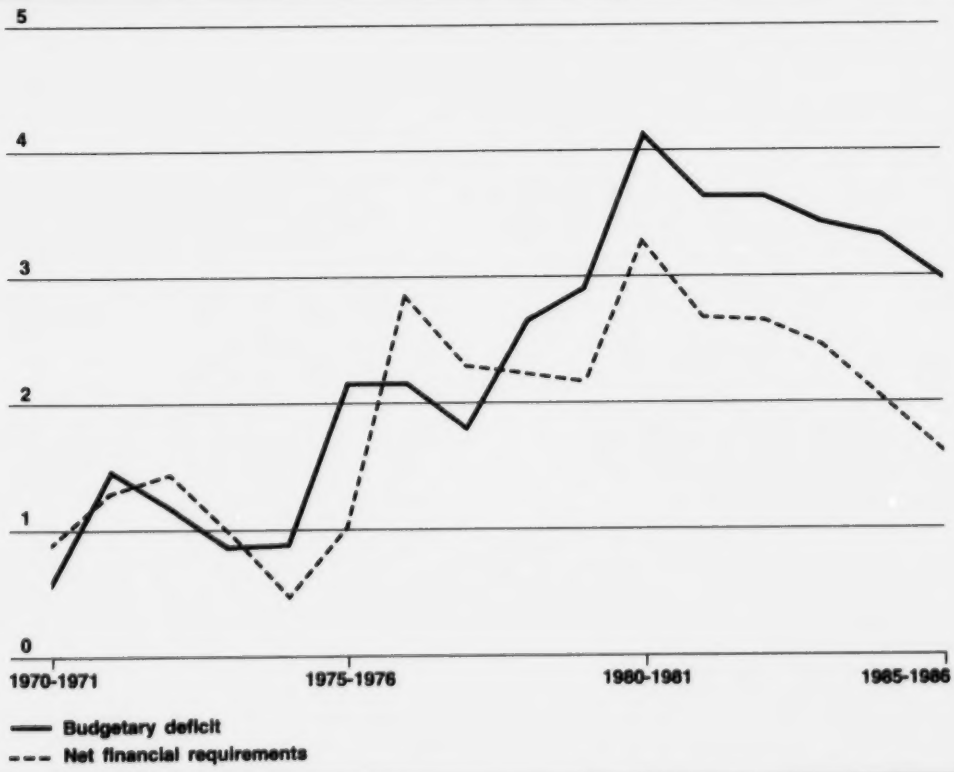
As we have seen, Québec's economy has undergone a number of major changes in recent years, some advantageous, others not. Unemployment and under-employment have reached unacceptable levels. The number of welfare recipients able to work has continued to grow and the increase in employment compared to the 1981 peak consists primarily of part-time positions in the less well-paid sectors. Chronic underinvestment persists. We will now examine how the Québec government's financial framework has evolved against this economic background which strongly infuences it.

(a) An increasingly heavy government debt

The Québec government's financial situation has deteriorated significantly over the last few years. In particular, it may be noted that the government's net debt, which reflects the accumulation of annual

Graph III.1
GOUVERNEMENT DU QUÉBEC
BUDGETARY DEFICIT AND NET FINANCIAL REQUIREMENTS

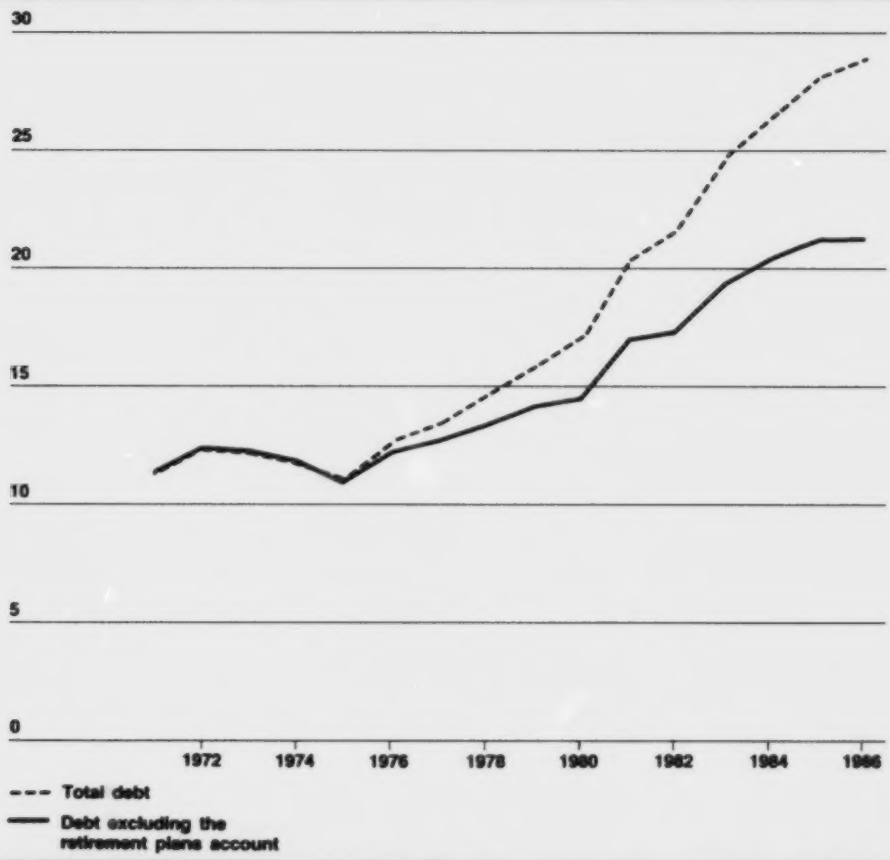
(as a percentage of GDP)



deficits, will have increased fivefold in nine years: at March 31, 1977, it stood at $5.0 billion; at next March 31, it should amount to $27.8 billion.[1]

The budgetary deficit and the net financial requirements levelled off at $3 billion and $2 billion respectively in recent years, so that they now represent a smaller proportion of the gross domestic product than in 1980. However, stabilizing the deficit and the net financial requirements did not prevent a sharp increase in the debt compared to our ability to repay. While the government's total debt[2] represented 17% of the GDP in 1980, it will represent 28.9% next March 31[3]. In 1971, it

Graph III.2
GOUVERNEMENT DU QUÉBEC
TOTAL DEBT AS A PERCENTAGE OF GDP
AS AT MARCH 31



1 Excluding the value of Hydro-Québec's accumulated reserves which were posted to the government's assets through an accounting adjustment in 1981-1982.

2 The government's total debt includes the long-term debt, Treasury bills, and the provision for the retirement plans of the public and parapublic sectors which is entered as a liability.

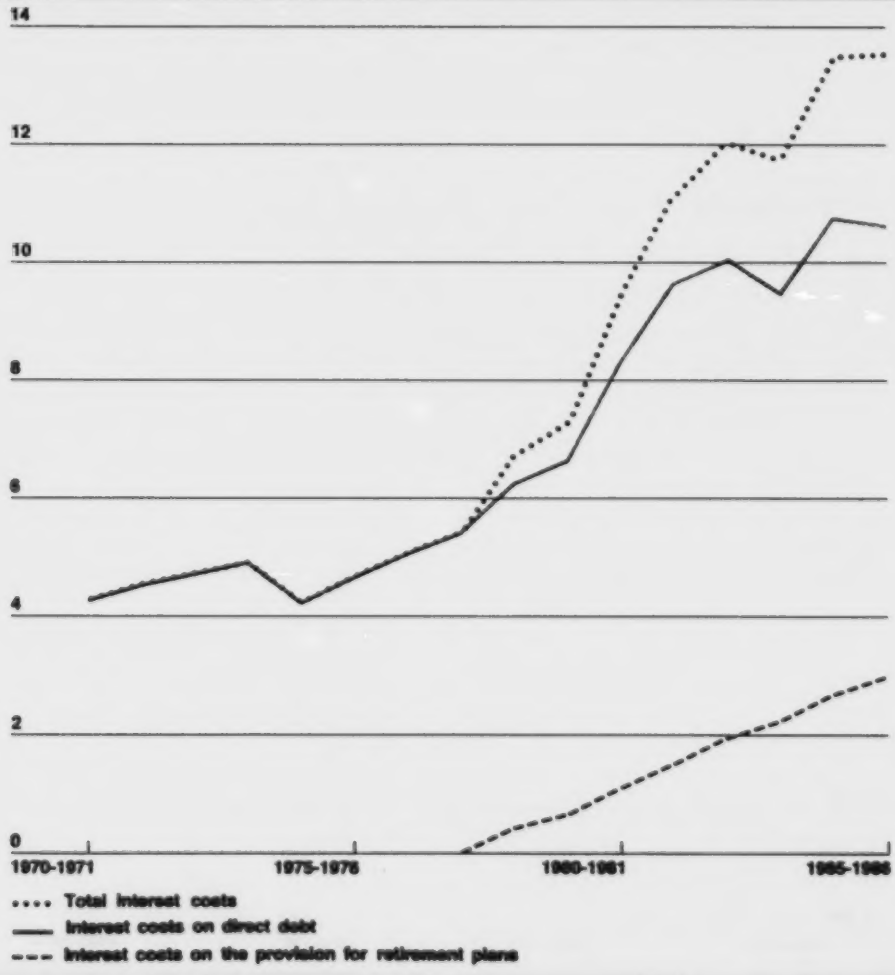
3 The percentage is calculated by dividing the debt at March 31 of a given year by the GDP of the calendar year ending the preceding December 31.

represented 11.2 %. This means that Québec's relative debt status has more than doubled in fifteen years.

This rapid increase in the debt reflects in part the new method of entering government commitments to the retirement plans in the public sector: since 1978-1979, a growing proportion of these commitments has been included each year in the government's total debt. Appendix 5 presents the main elements of the 1978 reform in the posting of retirement plans.

The corollary to the increase in the government debt is, of course, the ballooning of the debt service, particularly when interest rates are high. Thus, while the government spent $308 million in interest on the debt in 1974-1975, or 4.2 % of its budgetary revenue, the debt will cost $3.3 billion in 1985-1986, or 13.5 % of government revenue.

Graph III.3
GOUVERNEMENT DU QUÉBEC
INTEREST COSTS AS A PERCENTAGE
OF BUDGETARY REVENUE



(b) Current expenditure financed by borrowings

The most worrisome aspect of the Québec government's financial situation is probably the fact that, for some years now, the government has been borrowing large sums to finance its current expenditure. In other words, "to pay the grocery bill"!

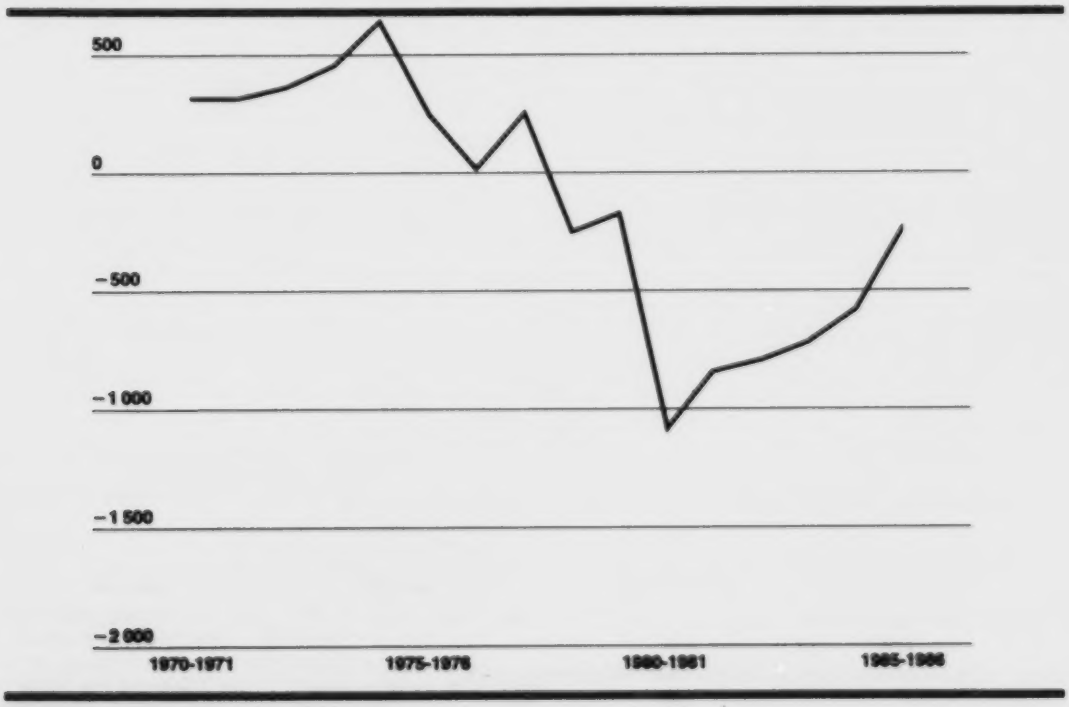
This aspect of public finances is measured in terms of the "balance of current transactions", which is the difference between the government's budgetary revenue and current expenditure. When the balance is negative, the government must borrow to finance current expenditure.

The guiding principle in this area is that the present generation must bear the cost of current expenditure from which it benefits. Whenever it fails to do so, it is giving to future generations the burden of paying for the services it is enjoying. It is obvious that such a principle cannot be applied mechanically every year. Governments must sometimes diverge temporarily from the "straight and narrow" because of the economic context. But in the medium and the long term, governments like Québec's must refrain from financing current expenditure through loans.

The expenditures used to calculate the "balance of current transactions" are defined as budgetary expenditures from which capital expenditure and the government's contribution as an employer to the retirement plans in the public and parapublic sector is substracted. This concept corresponds to one of the criteria traditionally used by rating agencies to evaluate the credit of Canadian provinces. The following graph gives the historical evolution of the balance of current transactions using this calculation.

Graph III.4
GOUVERNEMENT DU QUÉBEC
BALANCE OF CURRENT TRANSACTIONS

(in millions of dollars)



It will be noted that the balance of current transactions was positive until 1977-1978, but has been negative ever since. The negative balance grew significantly bigger from 1978-1979 until 1980-1981, but an improvement occurred in recent years and it is now $230 million. We are still far from having made up for the deterioration in the situation noted at the end of the 1970s and, particularly, in 1980-1981. In 1985-1986, three years after the economy began to pick up, Québec is still borrowing to finance current expenditure.

It should be pointed out that this rather uncomfortable situation involves the Québec government specifically and not the other components of the provincial public sector. Over the past ten years, for instance, the municipalities have managed to self-finance a large proportion of their capital expenditure; the same is true of Hydro-Québec, such that the relative proportion of their debt in the GDP has levelled off and even dropped slightly since 1982.

Recently, however, the rating agencies have tried to change their method of calculating the balance on current transactions for governments and treat contributions to retirement plans as current expenditure.

This new approach raises significant practical difficulties because experts do not agree. In particular, the means of treating this item varies widely from province to province.

Clearly, we must soon propose a valuation method and accounting methods that are more appropriate to the retirement plans. Whatever the exact results of this valuation, it will undoubtedly show that current expenditure financed by borrowing in 1985-1986 are above current estimates. The adjustment needed to balance current transactions will be increased to that extent.

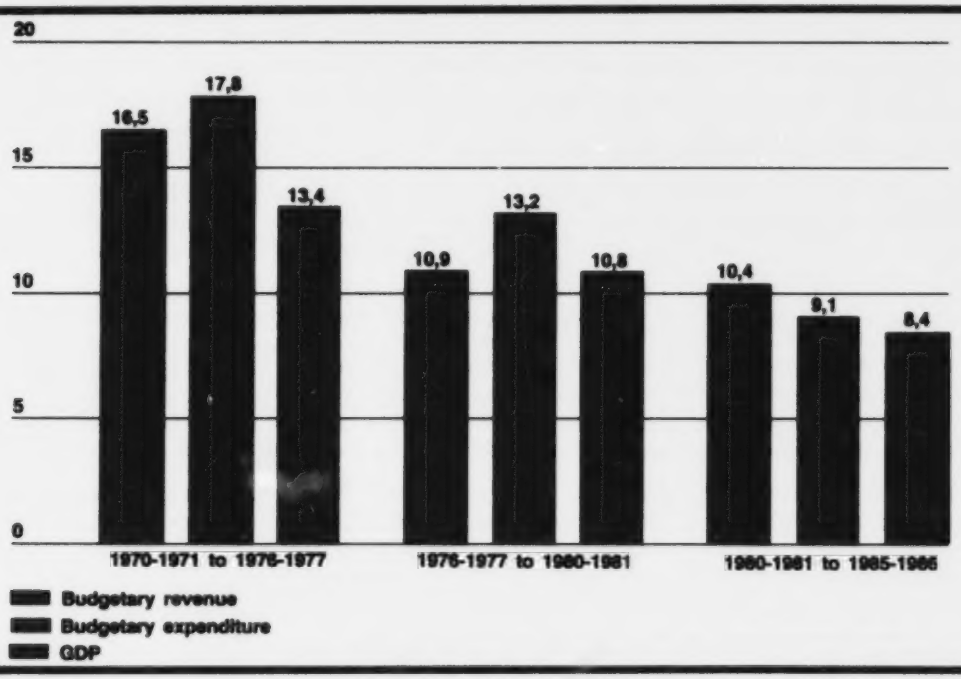
However, for purposes of comparison over time, the evaluation of Québec's balance on current transactions must exclude contributions to the retirement plans because, under the existing accounting method, very large sums began to appear in the budget beginning in 1978-1979 which had not previously been taken into account.

(c) Expenditure increasing too rapidly

Contrary to the trend since the beginning of the 1970s, the government's own-source revenue grew at the same rate as the economy between 1976-1977 and 1980-1981. This development resulted from the removal of the sales tax from certain categories of goods and an appreciable reduction in personal income tax, which have attenuated the growth of budgetary revenue.

Unfortunately, these reforms were not financed in a satisfactory manner, specifically through a tighter control of expenditure. This proved especially difficult, since the government was trying at the same time to post its retirement plan commitments more rigorously than had ever been done before. In fact, from 1976-1977 to 1980-1981, the rate of growth of expenditure exceeded that of the economy by 2.4 percentage points and that of budgetary revenue by 2.3 percentage points.

Graph III.5
GOUVERNEMENT DU QUÉBEC
ANNUAL COMPOUND GROWTH RATES
BUDGETARY REVENUE, BUDGETARY EXPENDITURE, GDP
(as a percentage)



Looking back, it is easy to see that we did not adjust rapidly enough to the structural slowdown the Québec economy began experiencing in the mid-1970s, a slowdown that was also affecting other industrialized countries. The rate of growth of Québec's GDP, which averaged 4.5 % at the beginning of the 1970s, fell to approximately 2.5 % after 1975.

Since there was no economic growth, the deficit swelled rapidly, rising from $900 million in 1977-1978 to almost $3 billion in 1980-1981, representing an unprecedented GDP of 4.1 %. Consequently, the government's total debt, which stood at $6.3 billion at March 31, 1977, had more than doubled four years later, representing over 20 % of the GDP. By financing most of its reforms by means of the deficit, the government not only accepted a rapid deterioration in its budgetary situation, but also sacrificed by the same token the financial flexibility it would have so badly needed to face the severe recession that hit Québec soon afterwards.

The policy adopted in Ontario during this same period was much more prudent. Revenue increased at a faster rate than expenditure, such that the deficit, which reached $1.8 billion in 1977-1978, had been cut back to $1.3 billion in 1980-1981, about the same amount as in 1976-1977. The Ontario government's debt[1] which represented 11.8 % of the GDP in March 1977 had risen only slightly to 13.3 % four years later.

1 Including the long-term consolidated debt, Treasury bills, and the provision for the retirement plans of public sector employees and the readjustment fund shown in the deficit.

(d) The hard days following the crisis

In the spring of 1981, faced with a budgetary deficit of nearly $3 billion and a listless economy, the government increased the tax burden on businesses. Then, in the fall of that year, when government revenue was beginning to feel the negative effects of the economic recession, the sales tax and the tax on fuel were increased, representing $900 million on an annual basis.

Given the extent of the recession and the state of public finances, the government introduced measures to recuperate part of the wages it paid its employees in order to make a budgetary saving of $500 million in 1982-1983, and imposed a graduated freeze on wages for 1983-1984.

At the same time, it adopted measures to reduce the rate of growth of expenditure. The most important one was the introduction of a new wage policy coupled with changes to the retirement plans for public sector employees. The objective of the new policy was to bring wages into line with those in the private sector, and so wage growth was pegged to the rate of inflation less 1.5 percentage points. Since wages account for about half the government's budget, such a policy should normally have gone a long way toward solving Québec's public finance problem. It did not, because of the extent of the recession, the slowdown in the growth of federal transfers and, paradoxically, the growth of budgetary expenditure which remained too high.

Despite the sacrifices asked of public sector employees and the taxpayers, new programs of expenditure were set up which, to a large extent, cancelled out the efforts it adopted to rationalize expenditure. From 1981-1982 to 1985-1986, for instance, the government agreed to new expenditures amounting to $1.6 billion, representing almost half the budgetary cutbacks made during that same period. In this respect, the economic recovery plan announced in November 1983 added several permanent programs to government expenditure, magnifying the present problems involving growth of expenditure.

The following table summarizes the essential elements of the restrictions the government had to deal with in preparing its last five budgets. It may be seen that, during the period in question, the automatic growth in expenditure, that is, the increase resulting simply from the continuation of existing programs, exceeded the corresponding increase in budgetary revenue, on the average, by approximately $650 million each year, to which the government added discretionary expenditures amounting to over $300 million per year. The result was an average annual gap of $1 billion and a cumulative gap of $5 billion, financed by a $905 million discretionary increase in own-source revenue (including $99 million through increases in taxes collected from the private sector), by budgetary cutbacks of over $3.7 billion and by a $250-million increase in the deficit.

Table III.1
AUTOMATIC AND DISCRETIONARY EVOLUTION OF THE REVENUE AND EXPENDITURE OF THE GOUVERNEMENT DU QUÉBEC FOR THE PERIOD 1980-1981 to 1985-1986
(In millions of dollars)

	Annual average	Whole period
"Automatic" growth of budgetary revenue[1]	1 692	8 457
"Automatic" growth of budgetary expenditure	−2 345	−11 723
Discretionary growth of budgetary expenditure[1]	− 318	− 1 590
Budget gap to be financed	− 971	− 4 856
Financing of budget gap		
(a) Discretionary increases in revenue:		
— taxes collected from:		
• private sector	20	99
• public sector[2]	80	400
— Charges and Crown corporation dividends[3]	81	406
(b) Budget cuts[4]	741	3 705
(c) Increase in deficit	49	246
Total	**971**	**4 856**

1 Calculated by subtracting the discretionary increases or decreases in revenue from the growth in revenue. Indexing of personal income tax exemptions is considered a discretionary decrease in revenue.

2 Excludes an estimate of developments granted over the year.

3 These increases come primarily from employer contributions to the Health Services Funds, collected from the government and Crown corporations, and from the Crown corporation tax on capital.

4 Cuts announced at the time the estimates were tabled.

(e) A procyclical fiscal and budgetary policy

By failing to take account of the structural slowdown of Western economies and by substantially reducing the fiscal burden of taxpayers at the end of the 1970s without introducing strict controls over expenditure, the government faced the 1980s on very slippery ground. Just when the worst economic recession in post-war times was beginning, with no choice but to avoid yet another increase in its deficit, the government was forced to adopt measures to adjust its budget that exacerbated the crisis. Furthermore, in recent years, the government has utilized a budgetary and fiscal policy that has amplified the economic cycle.

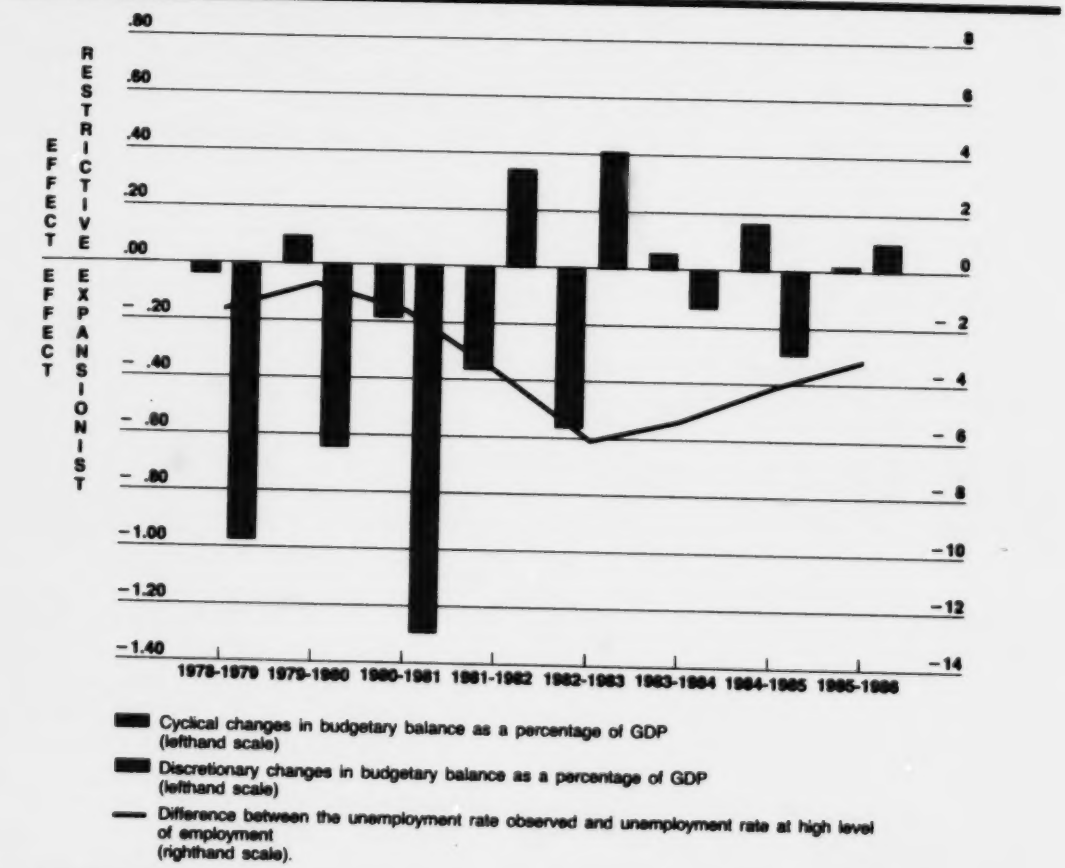
This observation is based on an examination of the evolution of the cyclically-adjusted budget deficit between 1978-1979 to 1985-1986. The fluctuations in the budgetary balance from one year to another reflect the government's decisions regarding revenue and expenditure, but they also reflect the impact of cyclical changes on items of revenue and expenditure that act as automatic stabilizers and reduce the fluctuations in the economy.

1 Generally speaking, the method used to calculate the corrected budgetary balance adjusted to cyclical changes can affect the accuracy of the results. Important fluctuations in interest rates in recent years, for instance, and the variability of federal transfers may have affected the magnitude of the trends observed but not their direction.

To discover the government's true budgetary orientation, the changes in the budgetary deficit must be decomposed into the cyclical element, that is, the element due to fluctuations in the economy, and the discretionary element, that is, the element resulting from the government's fiscal and budgetary decisions. When applied to the Québec government's budget, this approach shows that the discretionary element of the government's fiscal and budgetary policies has contributed to increase cyclical changes in recent years.

At the end of the 1970s, the government adopted a budgetary policy that was essentially expansionist in a relatively favourable economic climate. But the discretionary measures adopted after 1981-1982 (increased taxes and budgetary cutbacks) in order to avoid a more marked deterioration in the financial situation were introduced at the worst time, when the economy was crumbling. As a result, many of the positive effects of the automatic stabilizers were cancelled out.

Graph. III.6
EVOLUTION OF THE CYCLICALLY-ADJUSTED BUDGET BALANCE



In 1983-1984, the government reversed gears and adopted expansionist measures. Their effect became even more significant in 1984-1985, when the programs under the recovery plan of November 1983 reached their cruising speed. These funds were injected when economic recovery was already well under way.

There is no question of suggesting that the Québec government can eliminate economic cycles simply through its budgetary and fiscal policy. It should at least have enough financial flexibility in reserve to avoid having to make the economic situation yet worse when faced with a recession.

IV. BUDGETARY REVENUE

What we have seen so far clearly establishes the fact that, in Québec, budgetary deficits develop and sometimes become entrenched in public finances because of the excessively rapid growth in budgetary expenditure. This was true at the end of the 1970s when the deficit jumped $900 million to nearly $3 billion in three years. It was true during the recession of 1982, and in the years that followed, when the automatic growth in expenditure exceeded that of revenue, on the average by approximately $650 million each year. It is still true today, as we demonstrated in the first part of this document, since two-thirds of the gap that must be dealt with in 1986-1987 is due to overexpenditure in existing programs, cutbacks that have not been followed through and new decisions regarding expenditure. This is why we will look more closely at the breakdown of government expenditure in the following chapter.

Before doing so, however, it would be a good idea to take a look at government revenue. It will be a brief look, since an analysis has already been made in the White Paper on the Personal Tax and Transfer Systems. But it will nevertheless demonstrate that the solutions to the deficit problem that can be based on government revenue are rather limited. In fact, our overview will provide additional sources of concern as regards federal transfers.

In the Budgetary and Financial Policy Statement it issued last December, the government reduced marginal tax rates for individuals, reduced the tax on fuel in outlying regions and eliminated some of the tax on insurance premiums one year earlier than planned, thus reducing the Quebecer's tax burden considerably. The government acted with full knowledge of the 1986-1987 budgetary situation, because it was and still is persuaded that it was the only way to make Québec's taxation system more competitive.

Combined with the tax increases announced in Ontario's last Budget Speech, these measures served to reduce the tax burden differential of economic agents in the private sector in Québec and in Ontario. This spread will equal 4.4 % in 1986, compared to 15.1 % in 1982 (refer to Appendix 3 for the breakdown of the results and a summary of the method used to calculate the difference between the tax burdens in the two provinces).

Taken as a whole, the tax burden in Québec is now relatively competitive, at least compared to Ontario's. It is distributed unequally, however, since it is slightly lower (−2.2 %) for businesses and considerably higher (+7.2 %) for individuals.

Another major difference is that the Québec tax system is based primarily on taxes on production, especially on personal income tax. In 1986, Québec's local and provincial governments receive 42 % of their revenue from taxes on production, while Ontario's governments received only 31 %.

Table IV.1
MAIN SOURCES OF PROVINCIAL AND LOCAL TAXES COLLECTED FROM THE PRIVATE SECTOR
1986 TAXATION YEAR
(percentage distribution)

	Québec tax structure	Ontario tax structure
Taxes on production		
• personal income tax	33.0	22.8
• corporate taxes	9.1	8.4
SUBTOTAL	42.1	31.2
Property and per capita taxes		
• property taxes	22.9	29.7
• health insurance premiums	—	5.3
Consumption taxes	28.6	28.0
Taxes on natural resources and fees	6.4	5.8
TOTAL	**100.0**	**100.0**

Moreover, while 33 % of Québec's revenue comes from personal income tax, only 23 % of Ontario's revenue is from that source. This phenomenon is recent and results in particular from Québec's policy of indexing personal income tax and from the reform on personal income tax carried out in 1978.

The possible consequences of such a difference in fiscal structures are readily seen at a time when our economy is opening up more and more to world markets and when a movement towards freer trade is in the air. Thought must be given to ways of lightening the burden on production activities, even if that means relying more heavily on other taxes and tariffs. Otherwise, the present fiscal system could well be a handicap for Québec products in the struggle to conquer foreign markets.

Let us now look at a few other characteristics of our taxation system.

(a) Personal income tax

High-income taxpayers

Since the tax burden of a good many low-income taxpayers in Québec is lighter than in Ontario, most of the tax burden differential for individuals ($1 billion) falls to middle and high-income taxpayers. Thus, the personal income tax system is much more progressive in Québec than in Ontario (see the graphs in the appendix on this point) and it is not yet perfectly competitive for high-income taxpayers, despite the changes made to the tax structure for 1986. This group is subject to marginal taxation rates that are higher. In 1985, for instance, the maximum marginal rate in Québec was 62.1 % while in Ontario it was 52.0 %, a difference of 10.1 percentage points. The measures announced in the 1985-1986 Budget Speech and in the Budgetary and Financial Policy Statement of last December resulted in a reduction in this difference from 10.1 to 4.1 percentage points. This is the first time since 1977 that the difference has been lower than 5 percentage points and that the marginal taxation rate in Québec is not the highest in Canada. On the other hand, the Québec Stock Savings Plan has been made less advantageous.

Table IV.2
PROPORTION OF QUÉBEC TAXPAYERS COMPARED TO THOSE OF CANADA AND ONTARIO
(as a percentage)

	All taxpayers	Taxpayers earning less than $50 000[1]	Taxpayers earning $50 000[1] and more
Québec/Canada			
1976	24.5	24.5	24.4
1977	24.4	24.4	24.2
1978	25.1	25.1	21.7
1979	24.8	24.9	21.0
1980	*	*	*
1981	24.9	25.1	18.6
1982	24.9	25.0	18.6
1983	24.8	24.9	18.8
Québec/Ontario			
1976	61.9	61.9	63.5
1977	61.6	61.6	61.0
1978	65.3	65.5	54.5
1979	64.8	65.0	53.3
1980	*	*	*
1981	68.0	68.5	48.3
1982	67.2	67.8	45.8
1983	65.6	66.1	45.4

* No comparable fiscal data available.

1 In 1981 dollars adjusted according to the evolution of the average industrial wage.

Source: Federal tax statistics, 1976 to 1983.

There is reason to wonder about the effect such a large difference in taxation rates, which existed for several years, must have had on high-income taxpayers' desire to live in Québec. It is worth noting that the proportion of high-income Canadian taxpayers living in Québec dropped steadily between 1976 and 1983, falling from 24.4 % to 18.8 %. This trend was particularly strong as of 1978, when the difference between the maximum marginal rates in Québec and in Ontario reached 10 percentage points.

Incentive to work for low-income households

As demonstrated in the White Paper on the Personal Tax and Transfer Systems, low-income households live with a taxation and income security system that offer little incentive to reenter the labour market. This has unfortunate consequences on the workings of the labour market and on the vitality of the Québec economy. In addition, the existing income security system relieves poverty without giving any lasting solution to the problem of unemployment. With the exception of a few pilot projects, in no way does it attack the basic causes of long-term unemployment, namely, lack of education and lack of experience and specialization on the labour market.

Furthermore, the tax and transfer systems are not properly integrated, such that the government offers assistance to certain households with one hand, helping them meet essential needs, and imposes taxes on them with the other hand. Such a system, poorly integrated and offering little incentive to work, does not encourage families or individuals to take their lives in hand and creates financial as well as economic and social problems.

(b) Business taxes

Overall, the tax burden of Québec businesses compares favourably with what those firms would have to bear were they subject to Ontario's fiscal structure. Specifically, in 1986, their tax burden was 2.2 % lighter than it would have been in Ontario. This is due mainly to the high municipal and school taxes that businesses must pay in Ontario.

Table IV.3
QUÉBEC BUSINESS FIRMS' TAX BURDEN DIFFERENTIAL BY SOURCE
QUÉBEC AND ONTARIO TAX STRUCTURES
1986 TAXATION YEAR

	Differential	
	$M	**%**
Corporate taxes[1]	210	13.3
Consumption taxes	273	20.9
Various provincial fees and receipts	−89	−26.2
Municipal and school taxes	−515	−23.0
Total tax burden differential	**−121**	**−2.2**

1 Including taxes on profits, employer contributions to the Health Services Fund and taxes on capital.

In addition to the various taxes and tariffs businesses must pay, they are obliged to contribute to paragovernmental agencies on the basis of their aggregate contributory employment earnings. This is known as parataxation. All employers in Québec must contribute to various agencies in proportion to their aggregate contributory employment earnings. On average, this means contributing 2.05 % to the Commission de la santé et de la sécurité du travail, 1.8 % to the Régie des rentes du Québec, ⅛ of 1 % to the Commission des normes du travail and 3.29 % to the federal unemployment insurance plan.

Table IV.4
PARATAXATION RATES
EMPLOYER CONTRIBUTION
QUÉBEC AND ONTARIO
1986 TAXATION YEAR

	Maximum contributory salary	Québec	Ontario
	($)	**(%)**	**(%)**
Occupational health and safety	34 500[1]	2.05 [2]	2.66[2]
R.R.Q.	25 800	1.80	1.80
Labour standards	34 500	0.125	—
Unemployment insurance	25 740	3.29	3.29
Total		**7.27**	**7.75**

1 The maximum contributory salary is that which applies in Québec.
2 These rates represent the average contributory rates contemplated for all business firms.

In all, when the employer contribution to the Health Services Fund is added to parataxation, a Québec employer may have to pay over 10 % of his aggregate contributory employment earnings, compared to 7.75 % in Ontario. Moreover, the tax on capital, which is higher in Québec (0.45 % compared to 0.3 % in Ontario), adds an additional fixed cost to the tax burden of businesses. This is offset, however, by property taxes which are lower in Québec than in Ontario.

Overall, Québec's business tax system, which rests largely on fixed costs rather than variable ones (tax on corporate profits), has both its advantages and its disadvantages when compared to Ontario's system. Of course, these costs reduce the taxable revenue of businesses but they barely react to fluctuations in ability to pay. The system as a whole is relatively advantageous for efficient businesses with high profits, especially if they operate in the manufacturing sector, but it is less advantageous during periods of recession or under difficult economic circumstances.

Taxes collected from Québec firms account for 25 % of provincial and local governments' own-source revenues. Like individuals, they also benefit from public goods and services and a number of them receive a wide range of direct and indirect subsidies. According to a study by the secrétariat of the Conseil du trésor, which we will speak of further on, in 1983-1984, the Québec government paid $750 million more than Ontario in aid to firms in the private sector. More than half this amount went to the agricultural and forestry sectors.

In a great many cases, Québec subsidies are received along with federal subsidies. Moreover, these subsidies are not always coordinated with the tax incentives given the firms. Nor has it been proven that, in every sector and in every region, all the subsidies are truly effective means of stimulating economic growth and job creation.

(c) The erosion of the tax base

Québec's taxation system includes several fiscal expenses (tax shelters, for example) that add up to a great deal of money. Fiscal expenses are tax exemptions, abatements or credits that result in a reduction of government revenue. Except for the stock savings plan, the availability allowance and the Québec property tax credit, the fiscal expenses peculiar to Québec are relatively inexpensive. Generally, the same fiscal expenses are found in the Québec tax system and in that of the federal government and it is these common expenses that are the most onerous.

In the last decade, fiscal measures to encourage people to save, invest or find work have multiplied in Canada. The recent life exemption of $500 000 in capital gains introduced by the federal government has only added to existing fiscal expenses and accelerated the erosion of the personal income tax base. This last measure represents the most costly fiscal expense introduced in Canada since the tax reform of 1971, since it entails in all a loss of revenue in the order of $1.5 billion for the federal and provincial governments.

The justification for this federal policy is open to question at a time when there is a clear tendency in fiscal policy to simplify the tax system and reduce tax rates while gradually eliminating tax shelters. The U.S. goverment is planning a reform in this respect that would bring the maximum marginal personal tax rate down from 50 % to 35 %, in exchange for a major cut in certain fiscal expenses.

The Canadian government cannot ignore this tendency at a time when the United States is preparing to reduce its marginal tax rates and begin free trade discussions with Canada. Given the present budgetary context of the federal and Québec governments, such large tax expenses are open to question. On the other hand, it is obvious that, in this area, Québec cannot take action significantly different from that taken by Ottawa.

Consumer taxes also include exemptions that prey heavily on the public coffers. One need think only of the categories of goods, clothing, footwear and furniture, among others, that have been exempt from sales tax in Québec in recent years, while they are taxed in other provinces. Moreover, consumer taxes, the basis for which was set early in the century, have never been adjusted to the present context when services account for a substantial proportion of household consumption.

(d) Charges on services: an underused revenue source in Québec

From the point of view of public expenditure control, charging fees for services is of great importance in many cases where beneficiaries of these services can be properly identified. This is, of course, one way of increasing government revenue, but its principal merit is that it leads to rationalization of the demand for services by cutting down on their excessive use. It is the user of the service, and not the taxpayers, who pays the bill.

Moreover, such charges do not have any great negative effect on the economy, production or employment. On the contrary, they favour a better allocation of resources within the economy.

Despite the advantages, such fees are an underused tool in Québec. In education, for example, tuition fees represent only 7 % of the costs of the university network, and even at that they are less than half those applicable in Ontario. It is true that university studies are an investment in human resources from which the whole population benefits; it is therefore logical that they take up a large part of the costs. But in all fairness it must be recognized that the students themselves also benefit greatly from their studies.

Table IV.5
COMPARISON OF UNIVERSITY TUITION FEES
QUÉBEC AND ONTARIO
JANUARY 1986
(in dollars)

	Québec	Ontario
University tuition fees		
Bachelor's program — Administration	510	1 200
— Education	510	1 200
— Medicine	590	1 570
— Engineering	500	1 300
— Science	550	1 240
Master's and doctoral programs	510	1 250

In the realm of health and social services, the federal Bill C-3 considerably limits the possibility of charging user fees. In Québec, no charge is made except for stays in extended care hospital centres and for private and semi-private rooms in general hospitals. In any case, these costs are lower than those applicable in Ontario.

The government makes available to the public an entire range of goods and services, designed for specific, well-defined client groups: ski centres, campgrounds, technical help for businesses, and so on. In 1985-1986, the costs of producing these goods and services will be $1.3 billion, while the charges made for them will bring in only $437 million. Therefore, the global self-financing rate is barely 30 %. Without attempting to cover the costs completely, it is surely possible to increase the percentage of self-financing of these activities, especially as the government is in competition with the private sector in producing many of these goods and services.

(e) The gradual reduction of federal transfers

With regard to budgetary revenue, the government's financial problems have been greatly worsened by the slowing down of federal transfers since 1984-1985. Federal cash transfer payments, which account for more than a quarter of the government's budgetary revenue, grew by only 0.4 % in 1984-1985, and they are expected to go up by 1.4 % in 1985-1986. The rules in force since 1982, under the heading of equalization and financing of health and post-secondary education, are therefore beginning to have a serious impact on government revenue. Appendix 4 deals with the problems raised by federal transfers in greater detail.

The new method of computing equalization was introduced in 1982, substantially reducing payments to Québec and Manitoba. For this reason, the federal government provided for a temporary guarantee for the gradual changeover from the old to the new formula. However, when this guarantee expired in 1984-1985, it appeared that four provinces, including Québec, would receive less in transfers in 1985-1986. To deal with this problem the federal government decided, on April 1, 1985, to grant recipient provinces "supplementary equalization payments", which for Québec meant $110 million in 1985-1986. These lump sum payments were intended to represent a guarantee of 95 % of the 1984-1985 payments, but it appears that they would give Québec only 92.8 % if no corrective measures were applied. In coming years, Québec will feel the full impact of this new formula, which will result in large transfer reductions for Québec. Thus, the equalization payments that represented 16.0 % of budgetary revenue in 1982-1983 will account for only 11.2 % in 1986-1987.

Established program financing (EPF) in the realms of health and post-secondary education has also been subject to alterations that have affected Québec and the other provinces since 1982. As a result, Québec's revenue will have been reduced by close to $1.2 billion between 1982-1983 and 1985-1986; such losses put great pressure on government finances. Failing any new changes in methods of calculating, these cuts will mean additional decreases in revenue of $1.2 billion between 1986-1987 and 1988-1989.

In perpetuating the rules adopted in 1982, the federal government will be able to realize substantial savings in the coming years. And it is getting ready to impose further restrictions. On February 14, 1986, the Canadian Minister of Finance tabled a bill (C-96) to reduce the growth rate of the federal contribution to the EPF by two percentage points a year. This cut, designed to generate global savings of $2 billion per year as of 1990-1991, will be gradually implemented, beginning in 1986-1987, a year before the normal due date for the present fiscal arrangements. Given the anticipated costs in the health and post-secondary education sectors, Québec's financial burden will inevitably increase, while the changes made in the EPF since 1982 and the new cuts provided for under Bill C-96 will reduce transfers to Québec by $1 753 million in the next three years.

It is immediately clear how such a situation will affect the evolution of Québec's financial framework in the next few years, whereas one-quarter of our budgetary revenue will grow at a rate significantly below inflation.

The Québec government understands that the federal government has to resolve its own deficit problem. But analysis of the federal government's financial position over the years shows that transfers to the provinces are not the cause of the deficit. According to the National Accounts, federal government transfers to other levels of government represented 4.7 % of the GNP in 1977, and this proportion remained remarkably constant up to 1985. But other federal government expenditures increased substantially during the same period, from 16.1 % of the GNP in 1977 to 20.7 % in 1985.

Since last fall, the Québec government has expressed its criticisms of these transfer cuts to the federal government; a summary of Québec's position is presented in the appendices. The Québec government feels that, with regard to 1985-1986, the federal government must respect its commitments to the effect that equalization entitlements not drop below 95 % of the 1984-1985 entitlements.

(f) Budgetary revenue and the present impasse

Under the present circumstances, that is to say, without changing any part of the taxation system in force, Québec's own-source revenue should rise by about $1.1 billion in 1986-1987. This is an increase of 6.1 % which is slightly higher than the anticipated growth in Québec's wealth (5.8 %) despite the decreases in income and other taxes in effect since January 1986. These reductions total $510 million in 1986-1987, including $169 million as a result of measures announced in the Budgetary and Financial Policy Statement of last December.

As against that, it is expected that transfers from the federal government will drop by $75 million in 1986-1987 as compared with 1985-1986. This source of revenue is not under the control of the Québec government.

In all, it is estimated that the government's budgetary revenue will increase by $1 billion in 1986-1987, or only 4.1 %. Since the budgetary deficit, already excessive, cannot be allowed to increase further, we must, as a matter of priority, tackle expenditure to find a solution to our present budgetary deficit.

V. BUDGETARY EXPENDITURES: AN HISTORICAL EXAMINATION

Up to this point, we have seen that the current budgetary impasse would be difficult to solve by increasing the tax burden borne by Quebecers. Over the coming years, our economic priorities will take a completely different direction, and for good reason! As our economy becomes increasingly open to foreign competition, we must, at all costs, preserve and increase our ability to compete. Therefore, our tax system must be managed not so much to balance the budget by increasing taxes, as to correct a few structural problems, such as incentives to work and invest, or the rationalization of consumption of certain public services. Nor does the solution lie in additional borrowing. To do so would be to further open a door that is already gaping too wide: the increase in the debt service.

Attention must now be focussed on budgetary expenditures, and this is what we will be doing in this section.

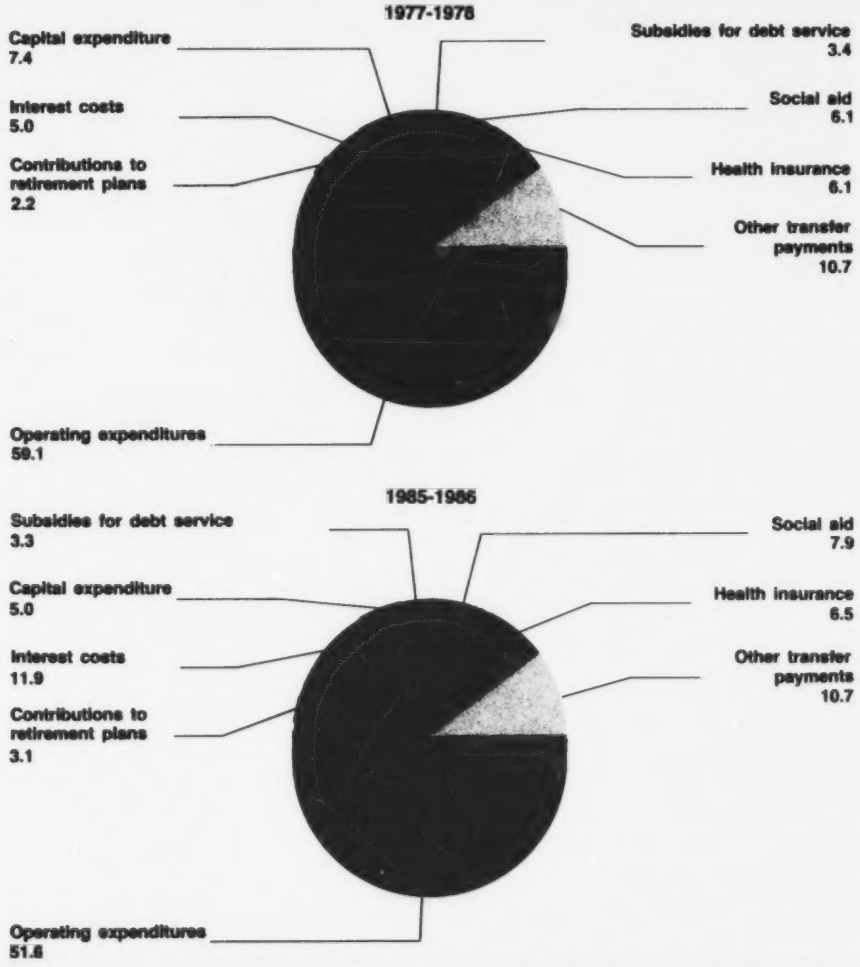
(a) How have expenditures evolved over the years?

As we have already seen, the weight of expenditures by the gouvernement du Québec in the economy has risen significantly over the past 15 years, from 18.3 % of GDP in 1970-1971 to 25.9 % in 1985-1986, after reaching a peak of 27.1 % in 1983-1984. At the same time, the breakdown of expenditures has changed substantially.

The following graph shows how this breakdown has changed from 1977-1978 to 1985-1986.The proportion allocated for the cost of government operations, education, health and social services

Graph V.1
GOUVERNEMENT DU QUÉBEC
BREAKDOWN OF EXPENDITURES

(as a percentage of total)



networks (wages and salaries, rent, etc.) has fallen considerably over the past nine years, from 59.1 % to 51.6 %. Capital expenditures have experienced a similar relative decline. However, the relative weight of social aid and expenditures related to health insurance has increased. After the rapid growth resulting from the 1978 accounting reform, employer contributions to the retirement

plans have grown at a much slower pace. The most significant change has been the dramatic growth in the share of the budget allocated to interest expenditures. This item more than doubled between 1977-1978 and 1985-1986, rising from 5.0 % to 11.9 %.

(b) Expenditures whose growth has been curbed

Operating expenditures

Operating expenditures amounted to $14 billion in 1985-1986. Included are amounts of $5.3 billion for the operations of the health and social services networks and $5.5 billion for the education network. They have risen at a much slower rate since 1982-1983, particularly as a result of the rollbacks in wages and salaries in 1983, the implementation of measures contained in the decrees which replaced collective agreements in the public and parapublic sectors, and various other expenditure cutback measures (other than wages and salaries). The rate of growth has fallen from the 15 % level in 1980-1981 and 1981-1982 to roughly 5 %. Cutbacks have produced the desired results for this expenditure item.

Contributions to the retirement plans

Since the 1978 retirement plans accounting reform, government contributions for current and past service to the retirement plans for public sector employees have followed basically the same trend as operating expenditures. Indeed, they fell in absolute terms in 1982-1983 and 1983-1984 when benefits under the plans and the employer share of contributions were revised. Whereas the retirement plans previously provided full adjustment to the cost of living, indexation is now limited to the rate of inflation less three percentage points. In addition, whereas the employer contribution used to amount to 140 % of employee contributions, that proportion now stands at 100 % for the three major plans covering virtually all participants. Here again, moderation has produced results.

Capital expenditures

There are two types of capital expenditures: those assumed by the government and those the government subsidizes. Direct capital expenditures have been quite stable over the past few years, which in part reflects the fact that Québec now has extensive infrastructures, especially for road transport, and in part that cuts can more easily be made in these expenditures. However, as will be seen further on, subsidies for capital expenditures are quite a different matter.

Other transfer payments

This category of expenditures has remained relatively stable over the past two years. It includes school bus transportation, student financial assistance, payments to municipalities in lieu of taxes, family allowances, amortization of accumulated deficits in the health, education and social services networks, subsidies to municipal housing bureaux, for reduced fares and passes for public transportation, farm income stabilization insurance and legal aid.

(c) Expenditures that continue to grow too rapidly

Interest costs

Interest costs, as was to be expected, are becoming one of the bugbears of Québec's public finances. Currently, they amount to $3.3 billion and are growing at a markedly faster rate than other expenditures. The dimensions of the problem can be grasped more easily by noting that the

increase in debt service alone has averaged $375 million per year over the last five years, using up almost 22 % of the automatic increase in budgetary revenue.

In this regard, a distinction should be made between two categories of interest costs.

The first concerns the direct debt. Since the early 1980s, this category has grown extremely rapidly, reflecting the mushrooming budgetary deficit and unprecedented interest rate levels. However, the fastest growth in interest costs is to be found in the provision for the public and parapublic sector retirement plans. These amounts currently stand at some $700 million per year, and are growing at about 20 % annually. Overall, the government's interest costs are growing at more than 8 % annually. At that rate, they will double every nine years.

Table V.1
EVOLUTION OF INTEREST COSTS OF THE GOUVERNEMENT DU QUÉBEC
(In millions of dollars)

	Interest on government direct debt	Interest on provision for retirement plans	Total
1977-1978	603	0	603
1978-1979	747	54	801
1979-1980	883	88	971
1980-1981	1 223	165	1 388
1981-1982	1 683	263	1 946
1982-1983	1 931	380	2 311
1983-1984	2 026	480	2 506
1984-1985	2 416	598	3 014
1985-1986	2 549	708	3 257

Debt service subsidies

Another rapidly growing category of expenditures is made up of debt service subsidies. These are granted to certain public sector entities to enable them to finance capital expenditures, for instance, in the health and education networks, public transportation and water purification. These subsidies have grown by over 20 % each year since 1983-1984.

Capital expenditure subsidies

The government also directly subsidizes the capital expenditures of certain public sector entities in Québec rather than subsidizing their debt service. These expenditures are generally growing at more than 10 % per year.

Social aid

Expenditures for social aid have also risen dramatically, especially in 1982-1983 and 1983-1984 following the economic recession. Despite the upturn in economic activity since then, they have continued to grow faster than expenditures as a whole, which is a matter of some concern. Whereas, in 1974, 6.6 % of the population depended on social aid, that figure now stands at 10.6 %.

Health Insurance

The health insurance expenditures for medical, dental and optometric care, and for drugs for the elderly and social aid recipients, are also growing much faster than other expenditures. The current growth rate is 11 % per year.

The increase in remuneration paid to health care professionals, which accounts for part of the increase, is influenced by three factors: the rate of increase in the scales they are awarded, the rate of increase in the number of physicians, 2 % to 3 % annually, and changes in medical practice (number and type of procedures) which adds a further 1 % annually to costs. Between 1980 and 1983, the number of physicians in Québec rose at a rate five times that of the increase in population.

In summary, the five expenditure categories for which growth is significantly in excess of other budgetary items currently total $8.9 billion, or roughly one-third of all expenditures. Taken as a whole, these items have grown by 15.6 % annually since 1977-1978. In contrast, inflation has averaged 8.2 % annually, while the other expenditure items have grown by 9.0 % per year over the same period.

(d) Expenditure control: a two-level exercise

It can be seen, from the preceding, that the government was unable to control overall expenditures sufficiently to avoid the current impasse.

The first reason is that it introduced new programs for a total of $1.6 billion, including $1.2 billion in 1983-1984 and 1984-1985 alone. In so doing, almost half the amount saved through its budgetary cutbacks was expended.

The second reason is that the corrective measures it did apply were not sufficiently vigorous in dealing with the internal dynamics of public expenditures, in other words, the "automatic" growth in programs.

This "automatic" growth in expenditure results from the continuation of existing programs. It is attributable in part to the growth in the payroll and to the movement of employees within wage scales, and in part to growth in clienteles and in the volume of services provided, for example, under social and or health insurance. A third growth factor is debt service, which stems from past deficits and changes in interest rates. Finally, the indexation of several categories of benefits, and the effects of inflation on government purchases, also add to the automatic increase in expenditures.

Although the automatic growth in expenditures is now less than growth in GDP, it has consistently and significantly exceeded the rate of inflation over the past few years. In 1981-1982, at a time when a costly collective agreement was in effect and interest rates were rising, the excess stood at 7.8 percentage points. The gap narrowed over the next four years, but nonetheless averaged 3.0 percentage points.

The conclusion, therefore, is that government must exercise control over public expenditures at two levels. The first, and the easiest, is simply to refrain from undertaking new expenditures. These expenditures, especially when they recur as more or less permanent programs, quickly become fixed elements within the budget. And when they are financed by borrowing, they are fixed within the public debt and debt service. This form of budgetary sedimentation, which has continued until quite recently, accounts for a large proportion of the current budgetary impasse.

Table V.2
GOUVERNEMENT DU QUÉBEC
EVOLUTION OF EXPENDITURE
(in millions of dollars)

	1981-1982	1982-1983	1983-1984	1984-1985	1985-1986
Budgetary expenditure (Corrected for anticipation of certain payments)	20 393	22 259	24 094	25 895	27 275
Less: Developments introduced during the year	77	100	617	644	152
Plus: Cuts made during the year	840	1 178	1 027	290	370
Expenditure not taking account of measures taken during the year	21 156	23 337	24 504	25 541	27 493
Automatic growth of expenditure during the year[1]	+3 564	+2 944	+2 245	+1 447	+1 598
Growth rate (%)	20.3	14.4	10.1	6.0	6.2
Inflation rate (%)[2]	12.5	10.8	5.8	4.3	4.0
Growth rate of GDP (%)[2]	13.8	5.0	7.6	8.0	7.5

1 Automatic growth of expenditure represents the difference between "Expenditure not taking account of measures taken during the year" (that is, expenditure that would have been incurred had no cuts or developments been made) and expenditure for the previous year.

Note that the total automatic growth of expenditure which is implicit in this table differs from that shown in Table III.1 by $75 million. This is due to the fact that in Table III.1 real expenditures are used as a basis for calculation while expenditure corrected for anticipation of certain payments is used in this table.

2 During the calendar year ended in December of the fiscal year considered.

Controls at the second level, which are much more difficult to implement, entail tackling, the budgetary bases of existing programs so as to reexamine the current level of expenditures and restrict their "automatic" increase. The mandate entrusted by the government to the task force on government administration and organization, presided by the Chairman of the Conseil du trésor, obviously lies at this level.

One way of better understanding the expenditure problem in Québec is to compare the amounts, distribution and mechanism of expenditures in Québec with those of another province with similar needs and economic structure. A comparative examination of our public expenditures with those of Ontario is very revealing in this regard.

VI. BUDGETARY EXPENDITURES: A COMPARATIVE EXAMINATION

For 1985-1986, budgetary expenditures will amount to $27.2 billion in Québec compared to $28.9 billion in Ontario, with a population 35 % greater. This is indeed surprising. This comparison is faulty, however, because two very different government entities are involved. For instance, in Ontario, many more activities are undertaken at the local level. In addition, public expenditures in both provinces must be standardized before they can be compared directly.

This chapter takes a new and to a large degree original look at public expenditures in Québec. It is essentially the outcome of a study recently undertaken by the secrétariat du Conseil du trésor. The purpose of the study is to compare, as objectively as possible, the cost of public services in Québec and Ontario. It examines two fiscal years: 1980-1981 and 1983-1984.

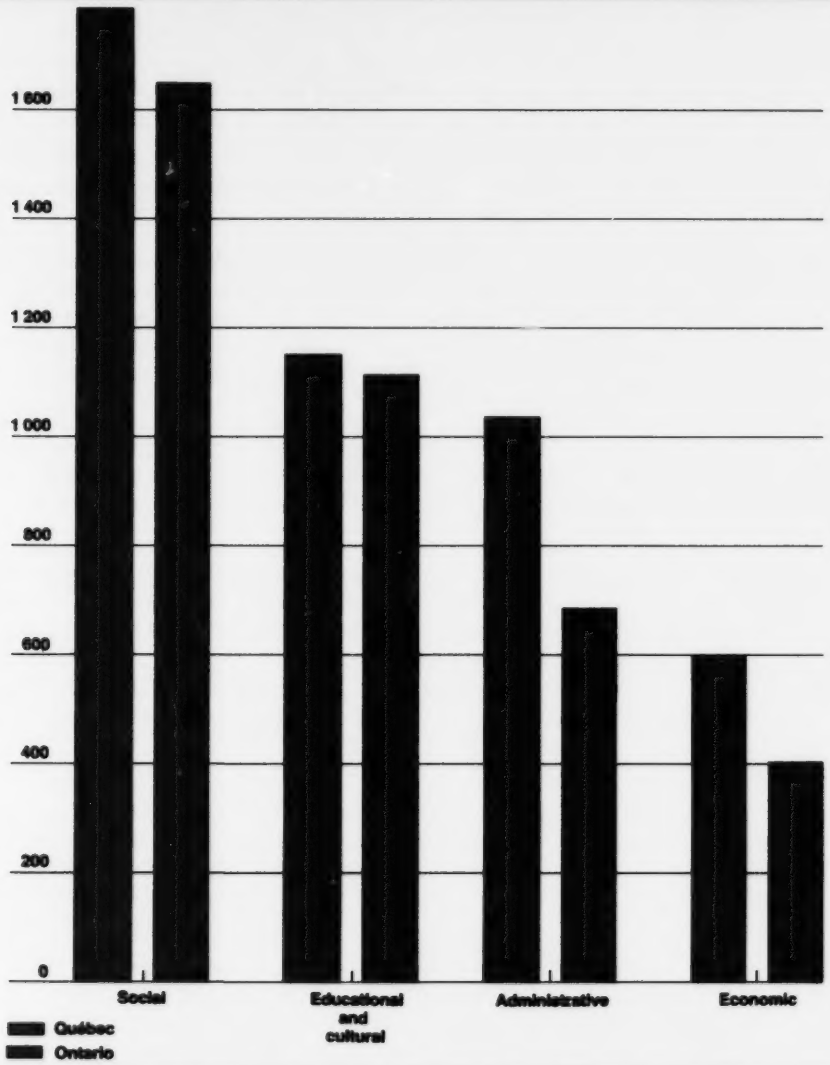
Before turning to a detailed analysis of the various budgetary items, let us examine the overall results.

During fiscal 1983-1984, gross standardized expenditures by departments and institutions subsidized by the governments of Québec and of Ontario stood at $29.8 and $34.2 billion respectively. Converting these expenditures into per capita amounts gives an average expenditure per Quebecer of $4 578 compared to $3 862 for Ontario. For the entire population of Québec, this $716 differential represents additional expenditures of $4.7 billion for the gouvernement du Québec. A substantial amount!

Three years earlier, during fiscal 1980-1981, the per capita spread was $660 ($3 435 per capita in Québec versus $2 775 in Ontario); therefore, this gap actually grew by an extra $56 per capita. Had it not been for the increase in the spread due to the debt service, the gap would have decreased by $73 per capita.

In terms of expenditures per mission, the lion's share goes to the social mission (health, social services and income security), both in Ontario and in Québec, for both years of the study. The proportion of expenditures allocated to the educational mission, the next largest, edged down in Ontario (from 30 % to 29 %) and fell from 28 % to 25 % in Québec. The relative size of the administrative mission grew slightly in Québec (from 22 % to 23 %), while falling in Ontario from 19 % to 18 %. The economic mission held its own at 13 % in Québec, but dropped from 13 % to 10 % in Ontario.

Graphique VI.1
COMPARISON OF EXPENDITURES BY MISSION
PRESENTATION IN PER CAPITA DOLLARS
QUÉBEC AND ONTARIO (1983-1984)



	Per capita cost in dollars 1980-1981		1983-1984		Spread 1983-1984
	Québec	Ontario	Québec	Ontario	(in millions of dollars)
Social mission	1 280.2	1 044.3	1 786.7	1 650.8	885.4
Educational and cultural mission	961.4	836.1	1 157.9	1 117.6	262.6
Administrative mission	753.4	521.5	1 037.4	690.2	2 262.0
Economic mission	440.0	373.1	596.0	403.0	1 257.4
Total	**3 435.0**	**2 775.0**	**4 578.0**	**3 861.6**	**4 667.4**

Turning to the actual spreads, it is interesting to note that the difference attributable to health, social and education expenditures has narrowed. Per capita expenditures remain higher in Québec than in Ontario, but the spread fell from $236 in 1980-1981 to $136 three years later in the first case, and from $125 to $40 in the second. However, the reverse is true with respect to the economic mission. Nevertheless, the most significant fact is undoubtedly the very large increase in per capita expenditures in Québec under the administrative mission. In 1983-1984, 49 % of the entire spread was attributable to the mission, compared to 35 % three years earlier. The increasing burden of debt service is a factor in this development.

(a) The social mission

The services provided under this mission can be divided into three groups: health and special care, income security and housing, the last item being relatively minor in dollar terms.

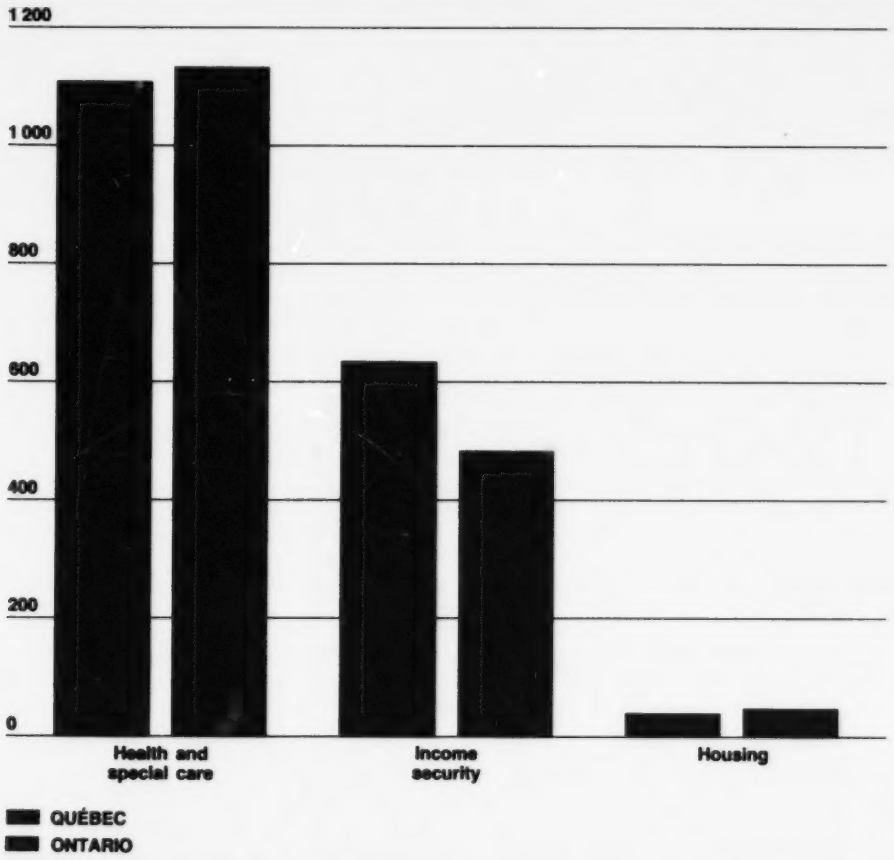
Expenditures for health and special care obviously increased in Québec between 1980-1981 and 1983-1984, but the increase was much less significant than in Ontario. Whereas these services were $125 per capita more expensive to provide in Québec in 1980-1981, Québec has since rationalized its expenditures so that in 1983-1984, these services were less costly here than in Ontario. However, this overall result conceals part of the story. Despite the wage reduction policy, hospital operations cost $84 per capita more in Québec in 1983-1984, while medical services cost $69 per capita less and special care establishments were $66 less for each Quebecer.

If further savings are to be achieved in this field, consideration must be given to the methods used to provide these services in the two provinces. Would it not be advisable, for instance, to consider a redistribution of responsibilities among the various groups and institutions working in this field: the ministère de la Santé et des Services sociaux, hospitals, CLSC, CRSSS, reception centres, private institutions and clinics?

The answers to these questions will be crucial for the future and we look to the Rochon Commission for some useful conclusions in this regard.

Income security is more costly in Québec. However, Quebecers enjoy a wider variety of programs in this field. It should be noted here that, in the study, Québec's expenditures include an amount of $606 million incurred by the Régie de l'assurance-automobile du Québec. Furthermore, Québec is less wealthy than Ontario, and so a larger proportion of its citizens are in need. Unless it is maintained that Québec's income security system provides excessively generous benefits, the questions to be asked are as follows: Is this the right way to provide assistance? Can the programs be modified to help and encourage more recipients to rejoin the labour market?

Graph VI.2
SOCIAL MISSION
COMPARISON OF PER CAPITA EXPENDITURES IN DOLLARS
QUÉBEC AND ONTARIO (1983-1984)

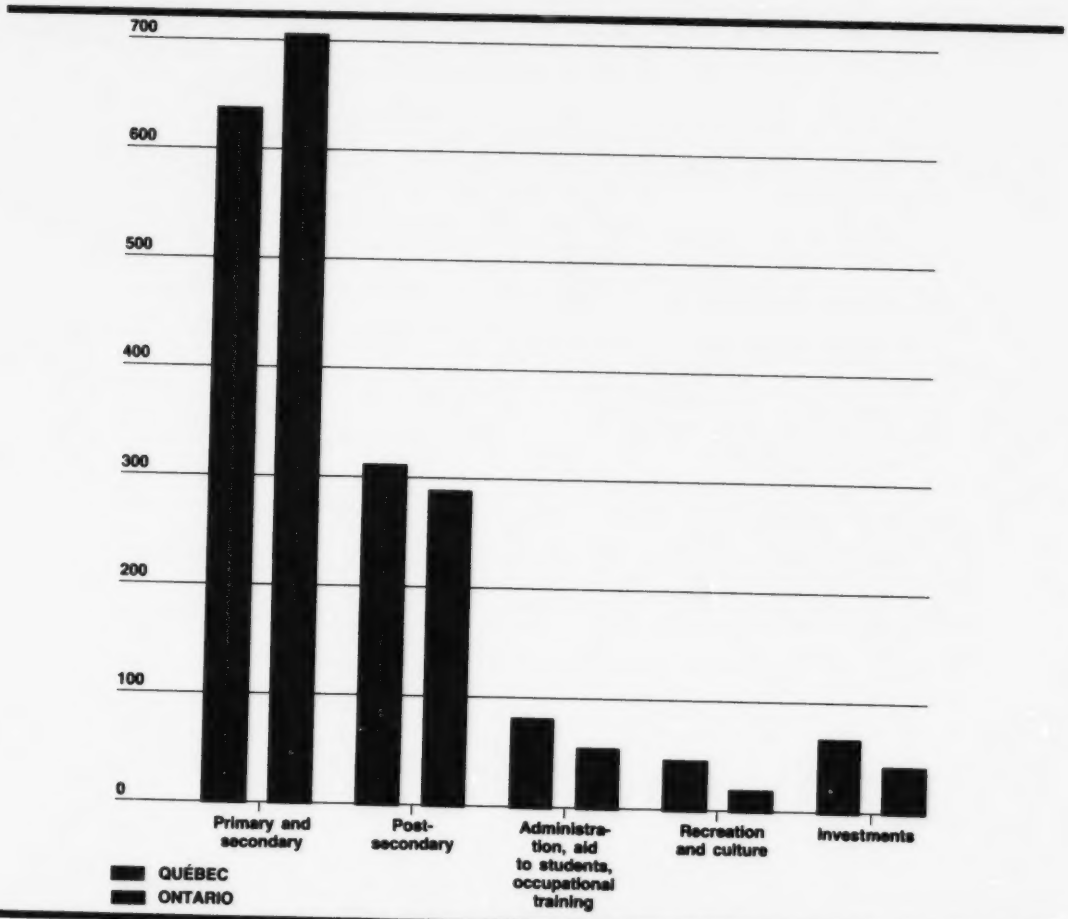


	Per capita cost in dollars			
	1980-1981		1983-1984	
	Québec	Ontario	Québec	Ontario
Health and special care	860.3	734.9	1 108.6	1 130.1
Income security	380.5	268.7	637.0	471.7
Housing	39.4	40.7	41.1	49.0
Total	**1 280.2**	**1 044.3**	**1 786.7**	**1 650.8**

(b) The educational and cultural mission

As was the case with health and social services, expenditure rationalization has appreciably improved Québec's situation compared to Ontario in the educational sector. Per capita expenditures for elementary, secondary and higher education were $805 in 1980-1981 in Québec and $734 in

Graph VI.3
EDUCATIONAL AND CULTURAL MISSION
COMPARISON OF PER CAPITA EXPENDITURES IN DOLLARS
QUÉBEC AND ONTARIO (1983-1984)



	Per capita cost in dollars			
	1980-1981		1983-1984	
	Québec	Ontario	Québec	Ontario
Primary and secondary	550.7	528.1	639.9	704.2
Post-secondary	253.8	206.0	312.3	290.5
Administration, aid to students, occupational training	66.7	44.1	83.6	57.6
Recreation and culture	37.2	18.9	44.9	20.5
Investments	53.0	39.0	77.2	44.8
Total	**961.4**	**836.1**	**1 157.9**	**1 117.6**

Ontario; in 1983-1984, expenditures in this sector had risen only $147 per person in Québec, reaching $952, while in Ontario the increase was much larger and per capita expenditures overtook Québec, hitting almost $1 000.

Despite this improvement, we must not lose sight of the fact that, in Québec, education still costs more per student than in Ontario. Indeed, the proportion of the population attending school is lower in Québec. In the public elementary and secondary sector, teacher workloads are still lighter than those of their colleagues in Ontario: the teacher-pupil ratio remains lower in Québec than in Ontario; the time spent in class is also lower. Furthermore, according to the ministère de l'Éducation, at the post-secondary level, college teacher workloads have increased considerably over the past years. These expenditures by student-time-equivalence are much lower than those of 1981-1982; they are reportedly also lower than those of Ontario.

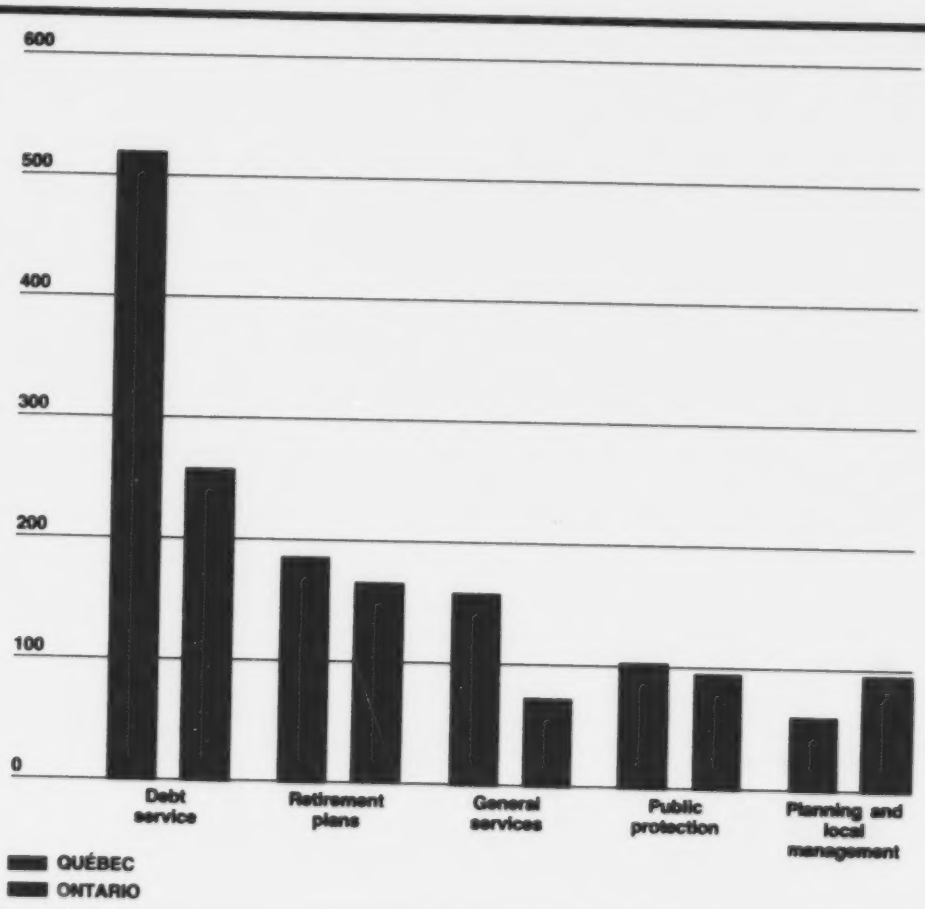
In addition, in the school transportation sector, expenditures were $19 per capita higher in Québec, mainly because a higher proportion of students are bused in Québec than in Ontario. Finally, on the administrative level, the operating costs of the ministère de l'Éducation are clearly higher than in Ontario.

(c) The administrative mission

As we have already seen, it is in the administrative mission that the greatest proportion of the total spread between Québec and Ontario in the cost of public services lies. We spend practically 50 % more than does Ontario for this type of service.

Of the many reasons for this situation, two stand out. First, the debt service is of much greater concern here than with our neighbours in Ontario. During the period under study, this item rose 27 % in Ontario, from $204 per capita to $258, while the increase in Québec was 55 %. As a result, the burden borne by Québec taxpayers attributable to debt service in 1983-1984 was twice as high as in Ontario. And the surcharge they pay in regard to past rather than current services continues to grow, since Québec's deficit is still higher than Ontario's.

Graph VI.4
ADMINISTRATIVE MISSION
COMPARISON OF PER CAPITA EXPENDITURES IN DOLLARS
QUÉBEC AND ONTARIO (1983-1984)



	Per capita cost in dollars			
	1980-1981		1983-1984	
	Québec	Ontario	Québec	Ontario
Debt service	335.8	203.5	519.8	258.4
Retirement plans[1]	141.3	114.6	188.0	161.9
General services	142.4	59.3	160.2	73.9
Public protection	83.8	70.6	105.4	97.5
Planning and local management	50.1	73.5	64.0	98.5
Total	**753.4**	**521.5**	**1 037.2**	**690.2**

1 Includes interest costs on the provision for pension plans appearing in government liabilities.

Second, Québec provides a greater number and a wider variety of general services than does Ontario. We have an array of organizations for consultation, coordination, development, etc. It has already been stated that Québec is over-governed. The time has come to examine the utility of several of these organizations, and the extent to which they duplicate the efforts of other organizations, whether federal, local or private. In this regard, it would be interesting to look at the conclusions that will be drawn by the task force recently formed and presided over by the Minister responsible for the Conseil du trésor.

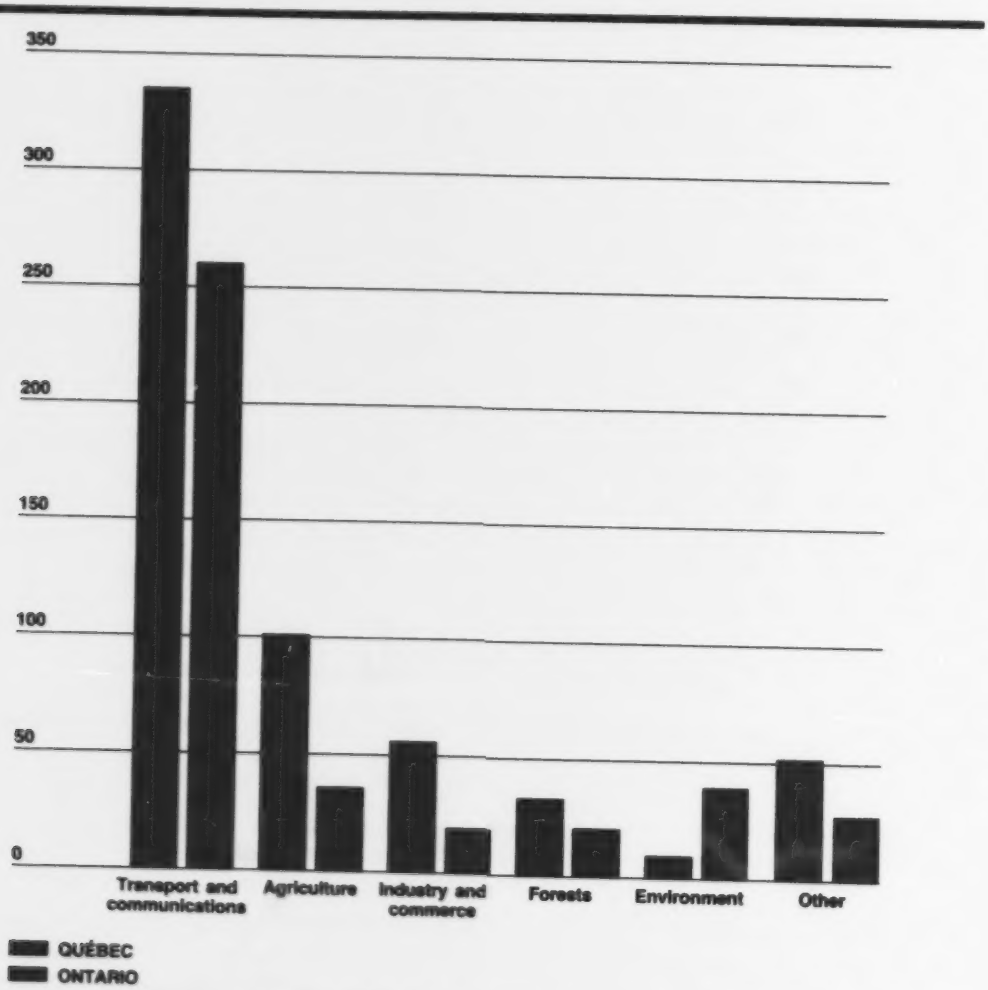
(d) The economic mission

In Québec, per capita expenditures for this mission have increased 35 % over the period under study compared to only 8 % in Ontario. Transportation and communications account for almost 60 % of the funds allocated to the economic mission. A fairly significant gap of $79 per capita exists between Québec and Ontario. Although the road and communications networks are roughly equivalent in the two provinces, a less temperate climate and Québec's ferry system combine to make part of this spread unavoidable.

The relative size of the forest industry in the two provinces logically entails higher per capita expenditures in Québec than in Ontario. But, then, should not the same logic apply with respect to agriculture, there being approximately twice as many farmers in Ontario as in Québec? Be that as it may, in 1983-1984, this industry was proportionately three times as expensive per capita in Québec than in Ontario ($101 versus $36).

With respect to industry and trade, expenditures have increased in Québec both in absolute and relative terms while they were falling in Ontario. Today, Québec devotes budgets that are three times greater than those of Ontario to this field.

Graph VI.5
ECONOMIC MISSION
COMPARISON OF PER CAPITA EXPENDITURES IN DOLLARS
QUÉBEC AND ONTARIO (1983-1984)



	Per capita cost in dollars			
	1980-1981		1983-1984	
	Québec	Ontario	Québec	Ontario
Transport and communication	263.6	233.4	338.8	260.3
Agriculture	56.4	25.2	101.4	36.0
Industry and commerce	45.1	27.1	59.8	19.9
Forests	24.5	19.7	32.6	20.0
Environment	7.9	51.1	11.3	39.2
Other	42.5	16.6	52.1	27.6
Total	**440.0**	**373.1**	**596.0**	**403.0**

(e) A critical examination of public expenditures: an indispensable operation

The preceding analysis has demonstrated the difficulty of holding public expenditures at a level that remains compatible with what is desirable given the tax effort and the budgetary deficit. Despite the cutbacks of recent years, we are still spending too much: $4.7 billion more than Ontario on a comparable basis. This is much too much if our tax effort is to be competitive and our debt load reasonable! Furthermore, the "automatic" growth of budget items via the continuation of existing programs gives every indication that the situation will not improve of itself. Quite the opposite!

In other words, a wise administration of the existing situation and a cautious approach to the creation of new expenditure programs are not sufficient. The merits of many existing expenditures must be examined and the necessary corrective action must be taken to stem the automatic growth of several others.

The government will be assisted in this work by a task force made up of high-calibre people who have an intimate knowledge of how Québec's government machinery works. In addition, the government's own apparatus is working on the problem, reviewing the manner in which the 1985-1986 budget is being implemented, and preparations for the 1986-1987 budget are being reworked from the beginning. We have already started to make needed changes. We now turn to some of the principles on which the government will act, in the coming years, with respect to public finances.

VII. THE ROAD TO RECOVERY

As announced in the inaugural message last December, the government's economic objective is to stimulate the creation of some 400 000 new jobs by 1990. This means an average of 80 000 jobs per year over the next five years, which may appear high given Québec's recent economic performance, but is well within the capacity of the province's vast potential. This objective is compatible with an overall rate of investment which could reach 19 % to 20 % of GDP by 1990.

For an open economy such as Québec's, this assumes that our economic environment will develop favourably, that is, there is no recession and real interest rates are more in line with past experience. If these conditions are satisfied, the surge in investment we are targeting should generate, in 1990, a level of output 4.5 % higher than what is indicated by the continuation of existing trends. In dollar terms, the increase in gross domestic product would amount to between $6 and $7 billion, or $2 500 per Québec household.

Workers and firms in all industrial sectors and all regions will reap the benefits of the increased prosperity. Nonetheless, the unemployed, those receiving social aid and, more generally, all those who have been discouraged by the existing situation, either from seeking employment, setting up a new business or modernizing existing production equipment, will derive the greatest benefit from this additional economic growth. It is estimated that, with the creation of 400 000 new jobs, the unemployment rate would fall to between 7.5 % and 9.0 % in 1990, depending on the number of additional workers the economic renewal attracts to the labour market. To achieve this ambitious objective, the government is relying above all on the entrepreneurial spirit of private sector economic agents. Nonetheless, it has already begun to restore order to its own house.

The government has set up a task force under the ministère de la Justice charged with reviewing government regulation. One of the major objectives is to place Québec firms in a situation that is at least as advantageous as those with which we are competing. This is an issue on which the government intends to act quickly.

At the same time, the government has undertaken a wide-ranging review of the role of Crown corporations active in industry and trade. The task force, headed by the Minister responsible for Privatization, has established the criteria under which the continued existence of Crown corporations is justified. This will enable the government to decide which can be transferred, in whole or in part, to the private sector, and those whose activity should be redirected.

The government has also intensified efforts aimed at increasing sales of electricity to our neighbours in the United States, which would enable Hydro-Québec to step up its investment and would raise the rate of investment in our economy by several notches.

The next, essential, step is to make use of the powerful instruments of fiscal and budgetary policy. We have already begun to do so, with the budgetary statement of last December 18, but more remains to be done, much more!

(a) Principles for sound management of public finances

Our public finances are at an impasse. Certain principles concerning sound financial management clearly emerge from the analyses presented in the preceding chapters.

Direct the tax system increasingly towards economic growth

The prime objective in regard to taxation will be to maintain and strengthen our economy's competitiveness. Our choice in this respect is limited to the extent that our economy will be more open than ever to international competition, particularly in the event of some form of free trade with the United States.

This means that the tax burden on the private sector, which remains 4.4 % higher than in Ontario, must be stabilized and, if possible, reduced even further within the next few years. At the same time, its nature and distribution among the various economic agents must be gradually altered, to become more "efficient" in regard to economic growth and job creation.

We have already mentioned the methods to be used to achieve these objectives. Briefly, the major ones are as follows:

— gradually shift the tax burden on production towards taxes that do not discourage producing in Québec;
— increase the incentive to work in income support programs;
— move to charging fees for services whose beneficiaries are easily identifiable;
— eliminate tax expenditures of doubtful utility and simplify the tax system; and
— stimulate entrepreneurship while facilitating, as far as taxation is concerned, the creation of new business, investment in productive capacity or regional development.

Obviously, this is not an exhaustive listing of the objectives our tax system is pursuing and will continue to pursue. But it does set out some core elements of the orientations the government intends to follow in regard to taxation over the coming years.

Improving financial flexibility

One of the more forceful lessons to be drawn from the recent past is that the government was in a very vulnerable situation when the recession hit Québec in 1981. The budgetary deficit was already excessive. Not only was it unable to ease the pain of the recession, but it exacerbated the situation as a result of being forced to raise taxes and cut expenditures at the worst possible moment.

Québec does not cause economic recessions; rather, it suffers their effects. When cyclical contractions grip our economy, some expenditures rise appreciably (social aid, for instance), and the yield from most of our taxes ceases to rise, and sometimes falls. The result is a temporary increase in the deficit. This is desirable because such fluctuations help moderate business cycles. This is the role of what are called "automatic stabilizers".

The rule of financial management to be drawn is that the government must at all times strive to maintain sufficient financial flexibility to give free rein to automatic stabilizers during recessions. In other words, "shift into neutral, but do not hit the brakes".

Balancing the current account

To stop borrowing to finance the grocery bill is both a matter of equity and of sound management. The budgetary practice over the past eight years of financing a substantial portion of current expenditures by borrowing is tantamount to shifting to future generations the cost of public services provided to today's generation. Of course, temporary departures from such a budgetary rule can be justified, for example, during a recession, but following this practice on a continuous basis is unacceptable.

This rule is applied as a sound management principle so that interest costs do not upset budgetary balances over many years in the future. Our public expenditures currently exceed those of Ontario by some $4.7 billion, on a comparable basis. Debt service accounts for one-third of this excess. This clearly demonstrates the debilitating effect of recurrent excessive deficits. It can be argued that the remaining two-thirds partly reflects social choices. However, Québec's population has certainly not made a conscious decision to let future generations pay the bills for its current expenditures.

The first corrective measure to be taken immediately will be to reestablish the balance of current transactions by bringing the budgetary deficit back to zero, not taking capital expenditures and employer contributions to retirement plans into account. Approximately, $1.5 billion are required for this purpose for 1986-1987, in view of the budget situation now facing the government.

In the medium term, however we will have to set our sights farther with regard to reducing the deficit and also avoid handing down to future generations current expenditures attributable to government contributions to retirement plans. In any case, the budget deficit must be reduced to much less than $3 billion if the government debt is to be brought back to a proportion of the gross domestic product that is more in keeping with our capacity to repay.

Public services adapted to needs and expenditures more compatible with revenue growth

If the trend line of public expenditures over the past few years is to be corrected, the internal mechanisms of programs will have to be reviewed, particularly if the government is to have additional funds available to deal with new needs and act on the determinants of economic growth. Québec's public sector will benefit from being competitive. This means a reassessment must be made of the effectiveness and efficiency of all public expenditures and the importance granted up till now to certain government services, and some of these must even be eliminated.

In this sense, it is important to realize that the provincial level is not necessarily the most appropriate level of government to satisfy public needs and expectations and to provide certain services. Indeed, it is extremely costly to provide a uniform level of services throughout the territory. A new division of responsibilities and financing among the various levels of government, emphasizing greater responsibility for local decision-makers, would surely enable the specific needs of local populations to be met more adequately.

To repeat, in Québec, budgetary deficits develop and become encrusted on the financial balances because of consistently excessive increases in expenditures.

Up till now, a budgetary logic had been followed according to which the level of expenditures essentially determined the amount of revenue and the deficit. From now on, that must be reversed. The budgetary deficit cannot be allowed to increase, quite the opposite, and it would be difficult to raise the tax burden of Québec taxpayers without endangering the competitiveness of our economy. Consequently, the amount of expenditures must be corrected and their mechanism controlled in such a way that they increase in line with the normal growth in budgetary revenue.

(b) How is the current impasse to be resolved?

A clear answer emerges from the application of the principles mentioned above to the existing $1.5 billion budgetary gap. In view of the need to maintain, and even bolster Québec's competitive position, any major, lasting increase under the current tax system is undesirable. Increases in certain fees can certainly be contemplated, or the elimination of certain tax privileges of dubious utility, but on the whole, the burden borne by Québec taxpayers must be stabilized. Similarly, any increase in the budgetary deficit, which is already too high, is out of the question. Rather, the focus must be on reductions over the medium term, in order to stop borrowing to finance current expenditures. Even if economic growth were to accelerate in the short term, it should be understood that the tax benefits would be modest and partially offset by the mechanism of federal transfers.

The fundamental question remains unchanged. Are we to raise taxes, borrow more or cut into expenditures? The answer we are now giving could hardly be less equivocal: the prerequisites for recovery are a review of expenditure programs, new budgetary cutbacks and reaching collective agreements between the government and its employees that reflect the state of public finances.

Last February 19, the government presented its wage offers preparatory to the negotiations with the unionized public sector employees. Considering the $100-million saving resulting from the proposed rearrangements in regard to certain normative clauses, these offers amount to a total increase of $333 million over the total 1985 remuneration package. These offers cannot be exceeded without placing increasing pressure — at a rate of almost $100 million per percentage point increase in wages — on the current budgetary deficit. The government views these proposals as fair and equitable.

Government expenditures in Québec, let us repeat, are some $4.7 billion higher than in Ontario, almost $716 per capita. The portion attributable to debt service must be subtracted from this spread, since it is a legacy we have inherited and must assume, no matter what. There remains a gap of almost $3 billion related to programs which, taken one at a time, are for the most part justifiable but, when grouped together, place a heavy burden on the government's financial health.

They must be examined to determine if they are still appropriate and carried out effectively. Consideration will have to be given to eliminating more or less useful programs. However, beginning right now, the essential part of the work to be done will be to make better use of the enormous financial resources the population has entrusted to the government, to pursue objectives shared by all. It is an extremely delicate task which must be executed with a great deal of rigour, equity and vision.

No matter how the problem is approached, pressing and painful choices must be made to extricate the government from its current budgetary impasse. Beyond this difficult period, however, we have a much more attractive option for maintaining public finances in balance: economic growth. If that option is to remain open, we must make the right choices today. This document will have achieved its purpose if it has brought us to make those choices as quickly and fairly as possible.

APPENDIX 1

Additional information on Québec's economic situation

Table 1.1
PRODUCTION, EMPLOYMENT, UNEMPLOYMENT

	1970	1971	1972	1973	1974	1975	1976	1977
GROSS DOMESTIC PRODUCT				**(in thousands of dollars)**				
Canada	87 071	96 034	106 785	125 384	149 883	168 010	195 539	214 941
(%)	(7.4)	(10.3)	(11.2)	(17.4)	(19.5)	(12.1)	(16.4)	(9.9)
Ontario	36 258	39 829	44 763	51 548	60 433	66 379	76 511	83 361
(%)	(6.8)	(9.8)	(12.4)	(15.2)	(17.2)	(9.8)	(15.3)	(9.0)
Québec	21 931	23 620	26 258	30 006	35 425	39 715	46 671	50 575
(%)	(6.8)	(7.7)	(11.2)	(14.3)	(18.1)	(12.1)	(17.5)	(8.4)
REAL DOMESTIC PRODUCT				**(percentage change)**				
Canada	2.2	6.0	5.9	7.8	4.6	0.9	5.1	2.8
Ontario	2.2	5.5	6.2	8.4	4.0	−0.7	4.3	2.5
Québec	3.2	5.0	4.8	6.0	5.9	0.9	4.7	2.0
United States	−0.3	3.1	5.4	5.5	−0.6	−0.7	4.9	5.2
OECD	3.5	3.7	5.3	6.1	0.8	−0.3	4.8	3.7
LABOUR FORCE				**(percentage change)**				
Canada	2.5	2.9	3.0	4.3	3.9	3.5	2.3	2.9
Ontario	3.2	3.6	3.6	3.6	4.4	3.6	1.7	2.7
Québec	1.1	2.6	1.5	4.9	2.8	3.0	1.6	2.6
EMPLOYMENT				**(percentage change)**				
Canada	1.1	2.3	3.0	5.0	4.2	1.7	2.1	1.8
Ontario	2.0	2.5	4.1	4.4	4.2	1.5	1.9	1.8
Québec	0.1	2.2	1.4	5.7	3.0	1.4	0.9	0.8
UNEMPLOYMENT				**(in thousands)**				
Unemployed								
Canada	475.8	535.2	552.9	514.8	514.3	689.7	726.1	849.2
Ontario	139.4	177.8	170.6	151.7	163.6	242.2	239.4	278.3
Québec	160.3	171.3	178.0	168.8	169.1	213.7	232.9	283.8
Unemployment insurance beneficiaries				**(in thousands)**				
Canada							701.4	751.6
Ontario							193.5	196.2
Québec							263.8	285.1
Households receiving social aid whose head is able to work				**(in thousands)**				
Québec		64	72	64	71	80	92	107
UNEMPLOYMENT RATE				**(percentage level)**				
Canada	5.7	6.2	6.2	5.6	5.3	6.9	7.1	8.1
Ontario	4.4	5.4	5.0	4.3	4.4	6.3	6.2	7.0
Québec	7.0	7.3	7.5	6.8	6.6	8.1	8.7	10.3
in age group: 15-24						14.0	15.5	17.9
25-34						6.5	7.1	9.0
35-44						5.1	5.7	6.8
45-54						5.5	5.7	6.4
55-64						5.6	5.4	7.4

Table 1.1 (cont'd)
PRODUCTION, EMPLOYMENT, UNEMPLOYMENT

	1978	1979	1980	1981	1982	1983	1984	1985
GROSS DOMESTIC PRODUCT				(in thousands of dollars)				
Canada	238 368	271 718	305 668	351 468	371 235	402 087	435 876	
(%)	(10.9)	(14.0)	(12.5)	(15.0)	(5.6)	(8.3)	(8.4)	
Ontario	91 334	103 062	114 767	131 680	137 232	151 650	167 741	
(%)	(9.6)	(12.8)	(11.4)	(14.7)	(4.2)	(10.5)	(10.6)	
Québec	56 553	62 977	70 312	80 015	84 009	90 432	97 631	
(%)	(11.8)	(11.4)	(11.6)	(13.8)	(5.0)	(7.6)	(8.0)	
REAL DOMESTIC PRODUCT				(percentage change)				
Canada	3.2	4.0	1.3	2.8	−4.3	2.7	4.9	4.4
Ontario	2.3	3.3	−0.8	2.2	−4.2	5.5	6.6	5.2
Québec	2.0	2.9	0.8	1.4	−5.0	3.1	5.2	4.0
United States	4.7	2.4	−0.3	2.5	−2.1	3.7	6.8	—
OECD	3.9	3.3	1.3	1.6	−0.2	2.5	4.5	—
LABOUR FORCE				(percentage change)				
Canada	3.8	3.1	3.1	2.9	0.5	1.9	1.8	1.9
Ontario	3.7	3.3	1.9	2.6	1.0	1.4	2.1	2.6
Québec	2.8	2.1	3.1	1.7	−1.4	2.4	1.8	1.9
EMPLOYMENT				(percentage change)				
Canada	3.5	4.1	3.0	2.8	−3.3	0.9	2.5	2.8
Ontario	3.4	4.1	1.5	2.9	−2.5	0.7	3.6	3.8
Québec	2.2	3.5	2.8	1.2	−5.2	2.2	3.0	3.0
UNEMPLOYMENT				(in thousands)				
Unemployed								
Canada	908.5	836.0	865.2	898.1	1 314.1	1 448.3	1 399.3	1 327.9
Ontario	298.2	277.9	297.2	292.7	440.3	473.8	422.8	384.5
Québec	308.4	277.9	294.2	314.1	413.3	426.9	400.5	376.4
Unemployment insurance beneficiaries				(in thousands)				
Canada	802.6	713.4	702.7	720.3	1 137.7	1 248.0	1 194.4	
Ontario	204.9	181.9	195.9	186.7	316.4	354.3	305.5	
Québec	302.4	269.1	259.6	273.2	392.5	384.8	371.0	
Households receiving social aid whose head is able to work				(in thousands)				
Québec	120	132	150	164	200	258	268	286
UNEMPLOYMENT RATE				(percentage level)				
Canada	8.4	7.5	7.5	7.5	11.0	11.9	11.3	10.5
Ontario	7.2	6.5	6.8	6.6	9.8	10.4	9.1	8.0
Québec	10.9	9.6	9.9	10.4	13.8	13.9	12.8	11.8
in age group: 15-24	18.5	16.5	17.2	17.5	23.1	23.0	19.9	18.1
25-34	9.3	8.7	8.6	9.8	13.4	13.9	13.0	12.4
35-44	7.5	6.3	6.2	7.1	10.3	10.1	10.0	8.6
45-54	7.6	6.4	7.4	7.1	8.7	9.3	9.3	8.5
55-64	7.7	6.0	6.2	6.0	8.9	9.7	9.7	10.3

Sources: Ministère de la Main-d'oeuvre et de la Sécurité du revenu
Statistics Canada
Conference Board of Canada
OECD.

Table 1.2
INVESTMENTS

	1970	1971	1972	1973	1974	1975	1976	1977
				(in millions of dollars)				
PRIVATE INVESTMENTS								
Residential								
Canada	3 138.0	4 025.0	4 820.0	5 977.5	7 010.1	7 113.9	10 852.6	11 064.0
Ontario	1 287.3	1 642.2	2 036.2	2 576.7	2 872.1	2 553.9	3 610.5	3 745.8
Québec	677.7	860.9	968.7	1 168.8	1 470.3	1 573.9	2 423.4	2 521.8
Non-residential								
Canada	9 389.5	10 147.7	11 038.1	13 283.3	16 389.8	18 324.7	19 900.8	21 424.0
Ontario	3 616.0	3 635.5	4 058.8	4 771.2	5 956.2	6 496.4	6 623.0	7 271.4
Québec	1 592.1	1 777.7	2 261.3	2 783.3	3 598.1	3 943.1	3 750.0	3 723.0
PUBLIC INVESTMENTS								
Canada	5 270.5	6 011.3	6 359.9	7 357.3	9 482.3	12 777.6	12 882.9	14 108.7
Ontario	2 024.2	2 182.5	2 141.2	2 366.6	2 987.4	3 870.0	3 714.7	3 715.0
Québec	1 148.3	1 511.3	1 594.3	1 874.4	2 329.8	3 653.4	3 639.3	4 457.5
PRIVATE AND PUBLIC INVESTMENTS								
Canada	17 798.0	20 184.0	22 218.0	26 618.1	32 882.2	38 216.2	43 636.3	46 597.5
Ontario	6 927.5	7 460.2	8 236.7	9 714.5	11 815.7	12 920.3	13 948.2	14 732.2
Québec	3 418.1	4 149.9	4 824.3	5 826.5	7 398.2	9 170.4	9 813.0	10 702.3
	1970	**1971**	**1972**	**1973**	**1974**	**1975**	**1976**	**1977**
				(as a percentage of GDP)				
RATE OF INVESTMENT								
Total investments								
United States	17.6	18.1	18.7	19.1	18.4	17.0	17.1	18.3
Seven main OECD countries	21.3	21.5	22.0	22.9	22.4	21.0	20.8	21.2
All OECD countries	21.7	21.9	22.4	23.2	22.6	21.4	21.2	21.5
Canada[2]	20.7	21.7	21.6	22.2	22.9	23.8	23.0	22.5
Ontario[2]	19.5	19.6	19.5	20.1	20.5	20.6	18.8	18.6
Québec[2]	15.5	17.8	18.7	19.9	21.7	24.0	21.6	21.8
Private, non-residential investments								
Canada	10.8	10.6	10.3	10.6	10.9	10.9	10.2	10.0
Ontario	10.0	9.1	9.1	9.3	9.9	9.8	8.7	8.7
Québec	7.3	7.5	8.6	9.3	10.2	9.9	8.0	7.4

Table 1.2 (cont'd)
INVESTMENTS

	1978	1979	1980	1981	1982	1983	1984	1985[1]
	(in millions of dollars)							
PRIVATE INVESTMENTS								
Residential								
Canada	11 450.4	11 617.4	11 013.6	13 135.4	10 148.8	12 994.1	12 453.2	12 904.6
Ontario	3 698.2	3 548.2	3 140.3	3 743.4	3 139.9	4 375.8	4 686.2	5 024.5
Québec	2 212.3	2 302.7	2 025.3	2 359.0	1 807.7	3 115.0	3 484.1	3 570.5
Non-residential								
Canada	23 797.6	30 630.2	37 650.2	45 301.5	42 506.2	36 957.3	39 152.0	45 144.8
Ontario	7 896.5	9 414.6	11 683.6	13 380.7	12 593.3	11 705.1	13 274.8	15 959.8
Québec	3 852.2	4 630.2	5 760.9	6 256.9	6 089.9	5 574.5	6 807.4	8 039.1
PUBLIC INVESTMENTS								
Canada	15 111.6	16 106.8	17 529.4	21 167.2	24 106.0	23 567.4	23 464.7	24 053.0
Ontario	3 966.3	4 130.5	4 282.2	5 617.1	6 689.8	6 642.7	6 865.5	6 901.8
Québec	4 729.4	4 921.3	5 032.7	5 123.3	5 199.9	5 257.6	5 271.7	5 309.6
PRIVATE AND PUBLIC INVESTMENTS								
Canada	50 359.6	58 354.4	66 193.1	79 604.0	76 760.9	73 518.7	75 069.9	82 102.4
Ontario	15 561.4	17 093.3	19 106.1	22 741.2	22 423.0	22 723.6	24 826.5	27 886.1
Québec	10 793.9	11 854.2	12 818.9	13 739.2	13 097.5	13 947.5	15 563.2	16 919.2

	1978	1979	1980	1981	1982	1983	1984	1985
	(as a percentage of GDP)							
RATE OF INVESTMENT								
Total investments								
United-States	19.5	19.8	18.5	17.8	16.5	16.8	17.6	—
Seven main OECD countries	22.0	22.3	21.8	21.1	20.0	19.5	19.7	—
All OECD countries	22.0	22.2	21.8	21.2	20.2	19.6	19.7	—
Canada[2]	22.0	22.4	22.6	23.3	21.4	19.0	18.0	—
Ontario[2]	17.9	17.5	17.3	18.0	17.0	15.7	15.6	—
Québec[2]	19.8	19.6	19.3	18.1	16.3	16.2	16.7	—
Private, non-residential investments								
Canada	10.0	11.3	12.3	12.9	11.4	9.2	9.0	9.6
Ontario	8.6	9.1	10.2	10.2	9.2	7.7	7.9	8.8
Québec	6.8	7.4	8.2	7.8	7.2	6.2	7.0	7.7

1 Private and Public Investments, Mid-year Survey, S.C., 61-206.

2 Investments according to the National Accounts concept.

Sources: Statistics Canada
OECD.

APPENDIX 2

Additional information on the Québec government's financial position

Table 2.1
GOUVERNEMENT DU QUÉBEC
STATEMENT OF FINANCIAL TRANSACTIONS
SUMMARY: 1970-1971 to 1985-1986
(In millions of dollars)

	1970-1971[1]	1971-1972[1]	1972-1973[1]	1973-1974	1974-1975	1975-1976	1976-1977	1977-1978
1. Budgetary transactions								
• Revenue								
• Own-source	+ 2 757.8	+ 3 185.3	+ 3 763.0	+ 4 360.3	+ 5 370.8	+ 6 125.9	+ 7 155.0	+ 8 009.4
• Federal transfers	+ 1 133.5	+ 1 326.4	+ 1 283.6	+ 1 405.8	+ 1 901.8	+ 2 254.8	+ 2 560.9	+ 3 135.9
• Total	+ 3 891.3	+ 4 511.7	+ 5 046.6	+ 5 766.1	+ 7 272.6	+ 8 380.7	+ 9 715.9	+ 11 145.3
• Expenditure	− 4 011.9	− 4 851.3	− 5 354.6	− 6 021.4	− 7 587.3	− 9 229.4	− 10 717.4	− 12 045.2
Deficit	− 120.6	− 339.6	− 308.0	− 255.3	− 314.7	− 848.7	− 1 001.5	− 899.9
2. Non-budgetary transactions								
Investments, loans and advances	− 87.0	− 69.1	− 65.0	− 121.8	− 146.0	− 185.9	− 182.5	− 248.1
Retirement plans account	+ 1.6	+ 1.1	− 0.5	+ 24.6	+ 104.3	+ 109.1	+ 186.4	+ 264.4
Other accounts	+ 15.6	+ 104.1	− 8.4	+ 55.7	+ 191.3	+ 519.9	− 335.5	− 287.4
Balance	− 69.8	+ 36.1	− 73.9	− 41.5	+ 149.6	+ 443.1	− 331.6	− 271.1
3. Net financial requirements	− 190.4	− 303.5	− 381.9	− 296.8	− 165.1	− 405.6	− 1 333.1	− 1 171.0
4. Financing								
Change in cash position	− 52.1	− 143.2	− 8.7	− 73.9	− 181.8	− 513.7	+ 330.7	+ 372.4
New borrowings	+ 372.7	+ 569.6	+ 579.6	+ 638.2	+ 586.1	+ 1 206.3	+ 1 354.6	+ 1 042.3
Repayments of borrowings	− 130.2	− 122.9	− 189.0	− 267.5	− 239.2	− 287.0	− 352.2	− 243.7
Total	**+ 190.4**	**+ 303.5**	**+ 381.9**	**+ 296.8**	**+ 165.1**	**+ 405.6**	**+ 1 333.1**	**+ 1 171.0**

	1978-1979	1979-1980	1980-1981	1981-1982	1982-1983	1983-1984	1984-1985	1975-1986[2]
1. Budgetary transactions								
• Revenue								
• Own-source	+ 8 566.3	+ 9 453.1	+ 10 722.3	+ 12 910.2	+ 13 918.0	+ 15 074.4	+ 15 946.5	+ 17 600.0
• Federal transfers	+ 3 332.7	+ 3 823.6	+ 3 971.7	+ 4 571.5	+ 5 292.3	+ 6 336.5	+ 6 363.5	+ 6 520.0
• Total	+ 11 899.0	+ 13 276.7	+ 14 694.0	+ 17 481.7	+ 19 210.3	+ 21 410.9	+ 22 310.0	+ 24 055.0
• Expenditure	− 13 387.2	− 15 110.3	− 17 592.0	− 20 393.4	− 22 259.3	− 24 523.5	− 25 542.5	− 27 200.0
Deficit	− 1 488.2	− 1 833.6	− 2 898.0	− 2 911.7	− 3 049.0	− 3 112.6	− 3 232.5	− 3 145.0
2. Non-budgetary transactions								
Investments, loans and advances	− 255.0	− 202.7	− 40.4	− 72.9	− 135.0	− 150.5	− 171.8	+ 150.0
Retirement plans account	+ 315.7	+ 682.8	+ 822.3	+ 1 007.3	+ 1 051.2	+ 1 056.7	+ 1 183.5	+ 1 270.0
Other accounts	+ 165.9	− 16.1	− 196.6	− 169.0	− 103.5	− 14.4	+ 218.8	+ 10.0
Balance	+ 226.6	+ 464.0	+ 585.3	+ 765.4	+ 812.7	+ 891.8	+ 1 230.5	+ 1 430.0
3. Net financial requirements	− 1 261.6	− 1 369.6	− 2 312.7	− 2 146.3	− 2 236.3	− 2 220.8	− 2 002.0	− 1 715.0
4. Financing								
Change in cash position	+ 49.6	+ 229.3	− 456.1	+ 207.9	− 75.5	− 13.7	− 211.0	− 70.0
New borrowings	+ 1 575.5	+ 1 648.9	+ 3 352.9	+ 2 951.6	+ 2 761.8	+ 2 797.0	+ 3 281.0	+ 2 990.0
Repayments of borrowings	− 363.5	− 508.6	− 584.1	− 1 013.2	− 450.0	− 562.5	− 1 068.0	− 1 205.0
Total	**+ 1 261.6**	**+ 1 369.6**	**+ 2 312.7**	**+ 2 146.3**	**+ 2 236.3**	**+ 2 220.8**	**+ 2 002.0**	**+ 1 715.0**

1 The figures presented for these years do not take account of the integration of operations at the Office des autoroutes du Québec, since the pertinent figures are not available.

2 Summary of financial transactions as at December 31, 1985.

N.B. For purposes of comparison, the financial data are presented on the basis of the budgetary and financial structure in effect for the 1985-1986 fiscal year. A (−) sign indicates a financial requirement and a (+) sign, a source of financing. For the change in cash position, a (−) sign indicates an increase and a (+) sign, a decrease.

Table 2.2
GOUVERNEMENT DU QUÉBEC
EVOLUTION OF BUDGETARY EXPENDITURE
(in millions of dollars)

	1977-1978	1978-1979	1979-1980	1980-1981	1981-1982	1982-1983	1983-1984	1984-1985	1985-1986
Operations	7 113	7 784	8 506	10 115	11 679	12 246	12 929	13 608	14 077
Growth (%)	—	9.4	9.3	18.9	15.5	4.9	5.6	5.3	3.4
Contribution to retirement plans	266	277	645	730	838	787	753	819	848
Growth (%)	—	4.1	132.9	13.2	14.8	−6.1	−4.3	8.8	3.5
Interest costs on direct debt	603	747	883	1 223	1 683	1 931	2 026	2 416	2 549
Growth (%)	—	23.9	18.2	38.5	37.6	14.7	4.9	19.2	5.5
Interest costs on retirement plan provision	—	54	88	165	263	380	480	598	708
Growth (%)	—	—	63.0	87.5	59.4	44.5	26.3	24.6	18.4
Total interest costs	603	801	971	1 388	1 946	2 311	2 506	3 014	3 257
Growth (%)	—	32.8	21.2	42.9	40.2	18.8	8.4	20.3	8.1
Direct capital expenditure	588	586	607	562	569	536	539	576	560
Growth (%)	—	−0.3	3.6	−7.4	1.2	−5.8	0.6	6.9	−2.8
Subsidies for capital expenditure	298	338	327	360	409	556	622	670	799
Growth (%)	—	13.4	−3.3	10.1	13.6	35.9	11.9	7.7	19.3
Total capital expenditure	886	924	934	922	978	1 092	1 161	1 246	1 359
Growth (%)	—	4.3	1.1	−1.3	6.1	11.7	6.3	7.3	9.1
Subsidies for the debt service	410	469	484	546	599	490	598	727	900
Growth (%)	—	14.4	3.2	12.8	9.7	−18.2	22.0	21.6	23.8
Social aid	737	826	894	1 051	1 200	1 519	1 837	2 011	2 162
Growth (%)	—	12.1	8.2	17.6	14.2	26.6	20.9	9.5	7.5
Health Insurance	738	825	981	1 158	1 241	1 251	1 471	1 585	1 762
Growth (%)	—	11.8	18.9	18.0	7.2	0.8	17.6	7.7	11.2
Other transfer payments	1 292	1 481	1 695	1 682	1 912	2 563	2 839	2 884	2 910
Growth (%)	—	14.6	14.4	−0.8	13.7	34.0	10.8	1.6	0.9
Adjusted expenditure	12 045	13 387	15 110	17 592	20 393	22 259	24 094	25 894	27 275
Growth (%)	—	11.1	12.9	16.4	15.9	9.2	8.2	7.5	5.3
Expenditure paid in advance in 1983-1984	—	—	—	—	—	—	431	−422	−5
Expenditure paid in advance 1984-1985	—	—	—	—	—	—	—	70	−70
Total expenditure	12 045	13 387	15 110	17 592	20 393	22 259	24 525	25 542	27 200
Growth (%)	—	11.1	12.9	16.4	15.9	9.2	10.2	4.1	6.5
GDP Growth (%)[1]	8.4	11.8	11.4	11.6	13.8	5.0	7.6	8.0	7.5
Inflation rate (%)[1]	7.9	8.8	9.2	10.2	12.5	10.8	5.8	4.4	4.0

1 During the calendar year ending in December of the fiscal year concerned.

Table 2.3
GOUVERNEMENT DU QUÉBEC
INTEREST COSTS ON DEBT

	Interest on direct debt		Interest on provision for retirement plans		Total interest costs	
	$M	% of budgetary revenue	$M	% of budgetary revenue	$M	% of budgetary revenue
1970-1971	166	4.27	—	—	166	4.27
1971-1972	204	4.52	—	—	204	4.52
1972-1973	238	4.72	—	—	238	4.72
1973-1974	284	4.93	—	—	284	4.93
1974-1975	308	4.24	—	—	308	4.24
1975-1976	392	4.68	—	—	392	4.68
1976-1977	492	5.06	—	—	492	5.06
1977-1978	603	5.41	—	—	603	5.41
1978-1979	747	6.28	54	0.45	801	6.73
1979-1980	883	6.65	88	0.66	971	7.31
1980-1981	1 223	8.32	165	1.12	1 388	9.44
1981-1982	1 683	9.63	263	1.51	1 946	11.14
1982-1983	1 931	10.05	380	1.98	2 311	12.03
1983-1984	2 026	9.46	480	2.24	2 506	11.70
1984-1985	2 416	10.83	598	2.68	3 014	13.51
1985-1986F	2 549	10.60	708	2.94	3 257	13.54

F: forecasts

Table 2.4
GOUVERNEMENT DU QUÉBEC
TOTAL DEBT

	Direct debt[1]		Provision for retirement plans		Total debt	
	$M	% of GDP	$M	% of GDP	$M	% of GDP
1971	2 457	11.20	—	—	2 457	11.20
1972	2 920	12.36	—	—	2 920	12.36
1973	3 207	12.21	—	—	3 207	12.21
1974	3 558	11.86	—	—	3 558	11.86
1975	3 858	10.89	67	0.19	3 925	11.08
1976	4 816	12.13	179	0.45	4 995	12.58
1977	5 934	12.71	354	0.76	6 288	13.47
1978	6 744	13.33	619	1.23	7 363	14.56
1979	7 976	14.10	915	1.62	8 891	15.72
1980	9 123	14.49	1 598	2.53	10 721	17.02
1981	11 895	16.92	2 420	3.44	14 315	20.36
1982	13 836	17.29	3 428	4.29	17 264	21.58
1983	16 175	19.25	4 489	5.35	20 664	24.60
1984	18 410	20.36	5 545	6.13	23 955	26.49
1985	20 623	21.12	6 730	6.90	27 353	28.02
1986F	22 338	21.24	8 030	7.64	30 368	28.88

1986F

F: forecasts

1 Includes Treasury bills and the long-term debt.

Table 2.5
GOUVERNEMENT DU QUÉBEC
BALANCE OF CURRENT TRANSACTIONS
(in millions of dollars)

	Budgetary expenditure	Contributions to retirement plans	Total capital expenditure[1]	Adjusted budgetary expenditure	Budgetary revenue	Balance of current transactions	Balance of current account as a percentage of budgetary revenue %
1970-71	– 4 011.9	—	– 438.0	– 3 573.9	3 891.3	317.4	8.16
1971-72	– 4 851.3	—	– 651.0	– 4 199.3	4 511.7	312.4	6.92
1972-73	– 5 354.6	—	– 674.0	– 4 680.6	5 046.6	366.0	7.25
1973-74	– 6 021.4	—	– 722.0	– 5 299.4	5 766.1	466.7	8.09
1974-75	– 7 587.3	– 79.0	– 885.0	– 6 623.3	7 272.6	649.3	8.93
1975-76	– 9 229.4	– 125.0	– 976.0	– 8 128.4	8 380.7	252.3	3.01
1976-77	– 10 717.4	– 206.0	– 818.0	– 9 693.4	9 715.9	22.5	0.23
1977-78	– 12 045.2	– 266.0	– 886.0	– 10 893.2	11 145.3	252.1	2.26
1978-79	– 13 387.2	– 331.0	– 924.0	– 12 132.2	11 899.0	– 233.2	– 1.96
1979-80	– 15 110.3	– 733.0	– 934.0	– 13 443.3	13 276.7	– 166.6	– 1.25
1980-81	– 17 592.0	– 895.0	– 922.0	– 15 775.0	14 694.0	– 1 081.0	– 7.36
1981-82	– 20 393.4	– 1 101.0	– 978.0	– 18 314.4	17 481.7	– 832.7	– 4.76
1982-83	– 22 259.3	– 1 167.0	– 1 092.0	– 20 000.3	19 210.3	– 790.0	– 4.11
1983-84	– 24 523.5	– 1 233.0	– 1 161.0	– 22 129.5	21 410.9	– 718.6	– 3.36
1984-85	– 25 542.5	– 1 416.6	– 1 246.0	– 22 879.9	22 310.0	– 569.9	– 2.55
1985-86F	– 27 200,0	– 1 556.0	– 1 359.0	– 24 285.0	24 055.0	– 230.0	– 0.96

1985-1986F

F: forecasts

A (–) sign indicates a financial requirement and a (+) sign, a source of financing.

Notes:

1 Total capital expenditure includes direct government capital expenditure and subsidies granted for capital expenditure.

2 The current account balance is equal to budgetary revenue less adjusted budgetary expenditure, that is, excluding government contributions to its employees' retirement plans and its total capital expenditure.

APPENDIX 3

Additional information on the fiscal situation of Québec's taxpayers

1. Method of assessing the comparative tax burden of Québec's taxpayers

The ministère des Finances has developed a method for assessing and comparing the present tax burden under the Québec and Ontario tax structures. This method consists in alternately applying to Québec's tax bases the Ontario and Québec tax structures, which are determined by the tax rates and exemptions in effect in both provinces.

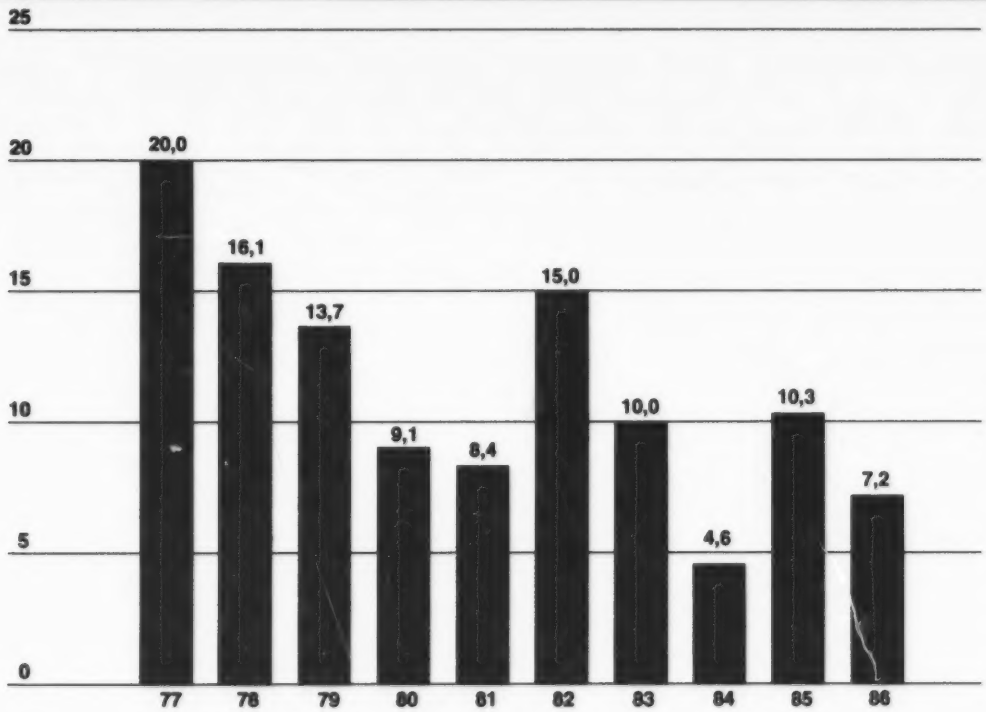
This method makes it possible to quantify the differential between the tax burden of Québec's taxpayers under the Québec tax structure and what that burden would be if the Ontario structure were applied. This differential corresponds to the difference between the level of own-source revenue of the provincial and local governments when they apply the Québec structure of financing public expenditure, and what the level would be if they applied the Ontario structure.

The own-source revenue of the local and provincial governments considered for purposes of this comparative study comes from three main sources: provincial tax revenue as such; revenue from charges for public goods and services, property taxes and various sources; and revenue from natural resources. Budgetary revenue concepts have been adjusted to make it easier to compare the tax burdens of the two provinces. The method used in this comparative study is described in more detailed fashion in Appendix III of Additional Information for the 1982-1983 Budget Speech, and the results of the latest update of this study are summarized in the graphs and tables of this Appendix. The data relative to the 1985 and 1986 taxation years were calculated on the basis of the economic and budgetary estimates of the April 23, 1985 Budget Speech, as well as the tax structures in effect in January 1986. The impact of the February 1986 federal budget has not been taken into account in this comparative analysis.

2. Tables and graphs on the fiscal situation of Québec taxpayers

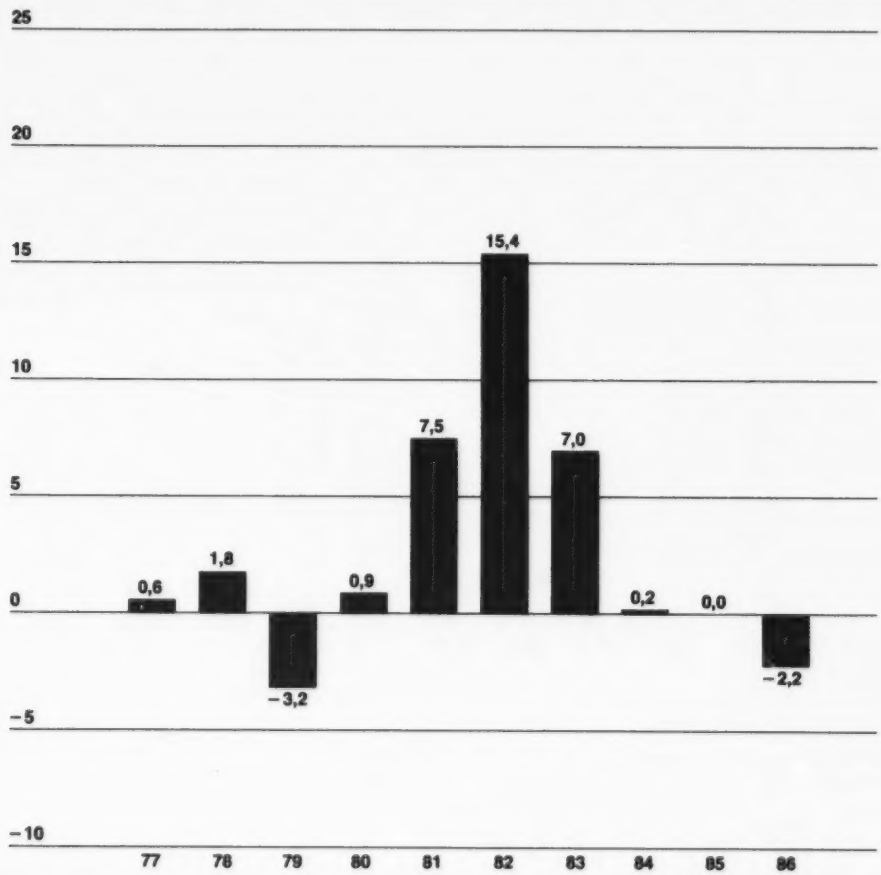
Graph 3.1
EVOLUTION OF QUÉBEC'S TAX BURDEN DIFFERENTIAL
QUÉBEC'S TAX STRUCTURE COMPARED WITH ONTARIO STRUCTURE
1977 TO 1986 (in percentages)

INDIVIDUALS



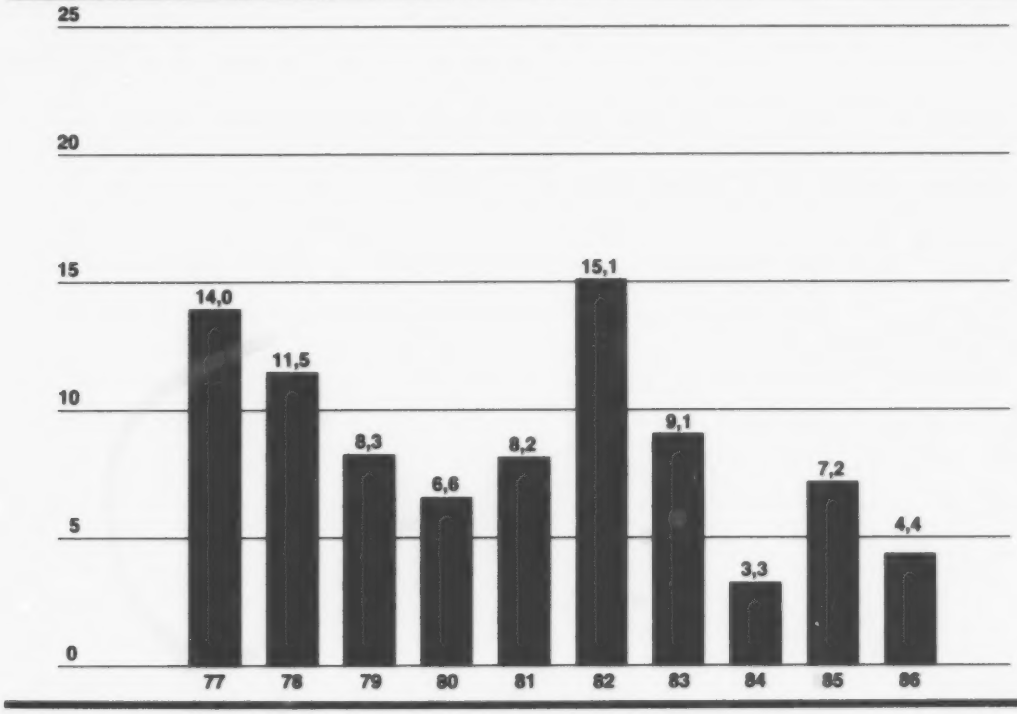
Graph 3.2
EVOLUTION OF QUÉBEC'S TAX BURDEN DIFFERENTIAL
QUÉBEC'S TAX STRUCTURE COMPARED WITH ONTARIO STRUCTURE
1977 TO 1986 (In percentages)

BUSINESS FIRMS

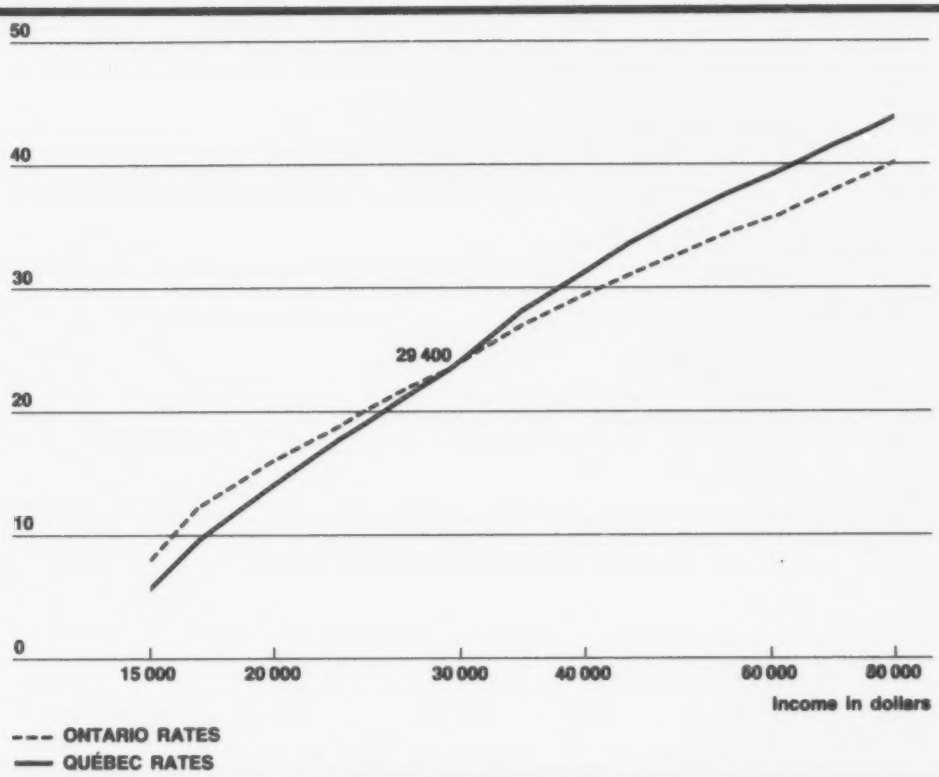


Graph 3.3
EVOLUTION OF QUÉBEC'S TAX BURDEN DIFFERENTIAL
QUÉBEC'S TAX STRUCTURE COMPARED WITH ONTARIO STRUCTURE
1977 TO 1986 (in percentages)

PRIVATE SECTOR (INDIVIDUALS AND BUSINESS FIRMS)



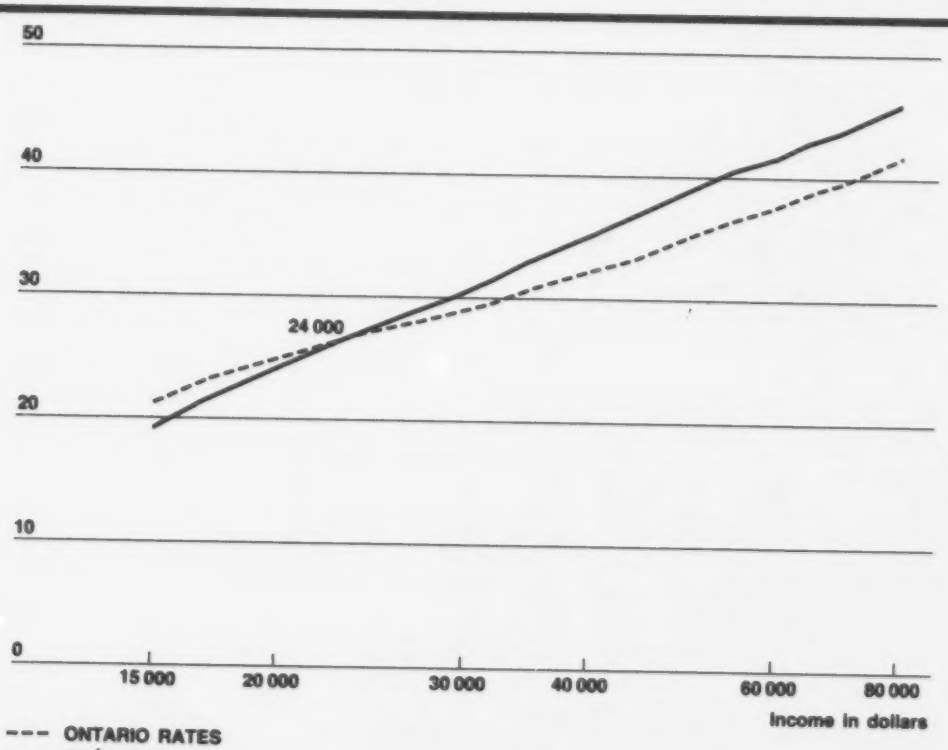
Graph 3.4
AVERAGE TAX RATES
QUÉBEC AND ONTARIO
1986 TAXATION YEAR
COUPLE WITH TWO CHILDREN (6-11 YRS.)
(average rate as a percentage)



N.B.: — Federal and provincial income taxes, property and consumption taxes and health insurance premiums less family allowances and various tax credits.
— The graph does not take account of the impact of the February 1986 federal budget.
— Semi-logarithmic scale.

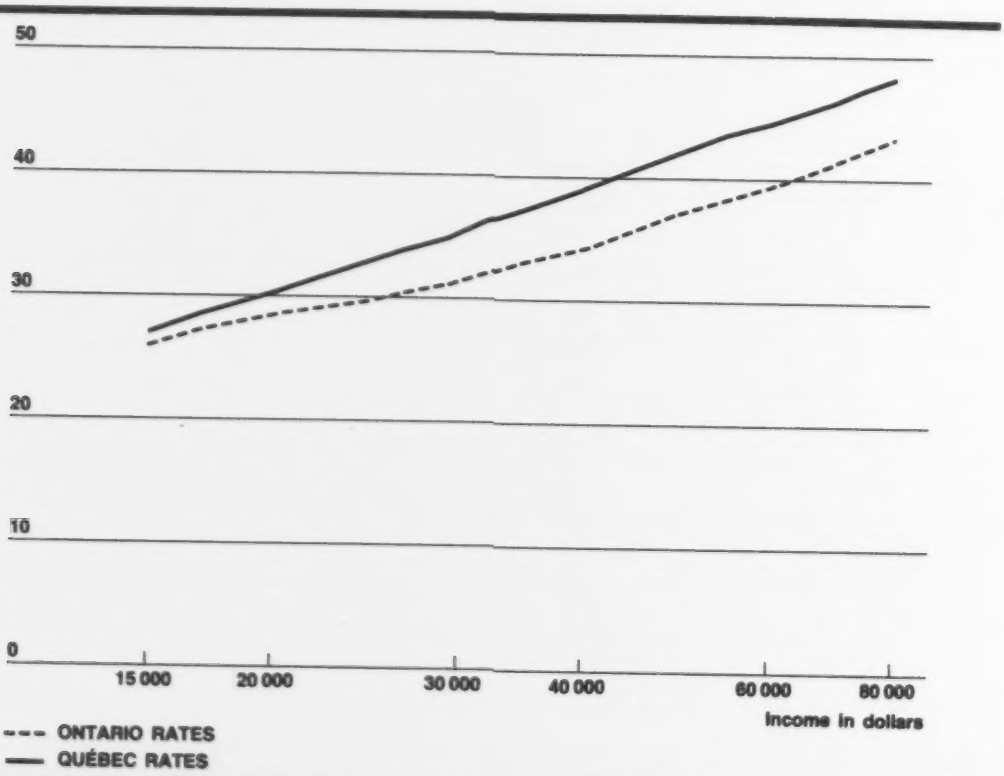
Graph 3.5
AVERAGE TAX RATES
QUÉBEC AND ONTARIO
1986 TAXATION YEAR
CHILDLESS COUPLE

(average rate as a percentage)



N.B.: — Federal and provincial income taxes, property and consumption taxes and health insurance premiums less family allowances and various tax credits.
— The graph does not take account of the impact of the February 1986 federal budget.
— Semi-logarithmic scale.

Graph 3.6
AVERAGE TAX RATES
QUÉBEC AND ONTARIO
1986 TAXATION YEAR
SINGLE PERSON
(average rate as a percentage)



N.B.: — Federal and provincial income taxes, property and consumption taxes and health insurance premiums less family allowances and various tax credits.
— The graph does not take account of the impact of the February 1986 federal budget.
— Semi-logarithmic scale.

Graph 3.7
EVOLUTION OF AVERAGE TAXATION RATES IN QUÉBEC AND IN ONTARIO
COUPLE WITH TWO CHILDREN (6-11 YRS.) EARNING THE AVERAGE FAMILY INCOME
1972 TO 1986 TAXATION YEARS
(as a percentage)

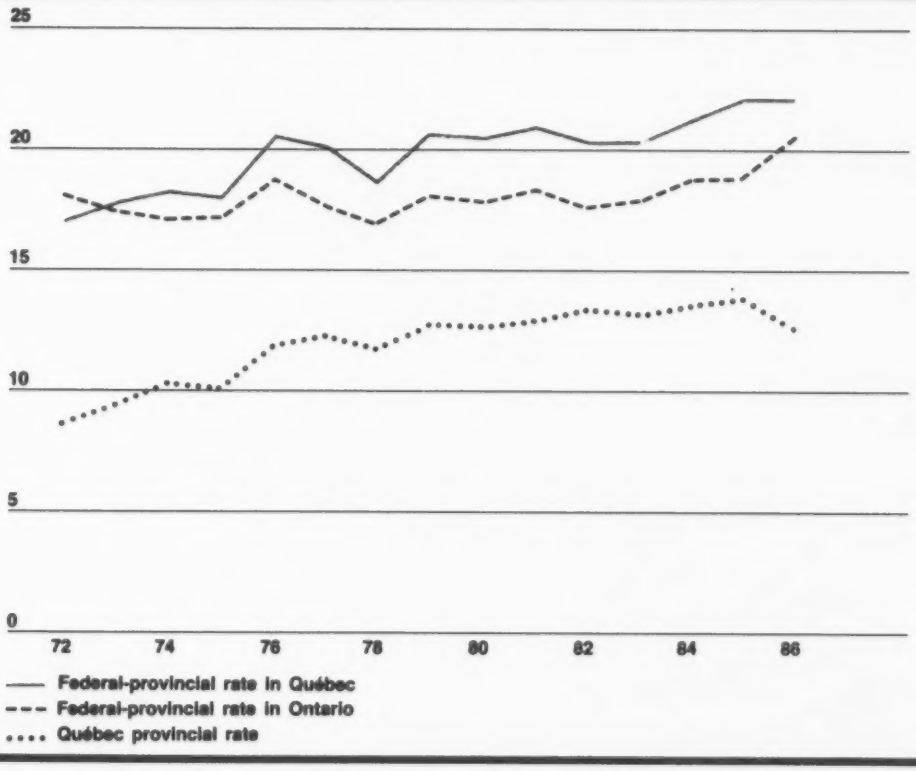


Table 3.1
EVOLUTION OF TAX BURDEN DIFFERENTIAL
ALL OF QUÉBEC'S ECONOMIC AGENTS
QUÉBEC'S TAX STRUCTURE COMPARED WITH ONTARIO STRUCTURE

	Private sector		Public sector	All economic agents	
	$M	%	$M	$M	%
1977	1 107	14.0	131	1 238	15.2
1978	992	11.5	157	1 149	13.0
1979	798	8.3	162	960	9.7
1980	719	6.6	228	948	8.4
1981	1 011	8.2	469	1 479	11.6
1982	2 006	15.1	666	2 672	19.6
1983	1 334	9.1	690	2 024	13.4
1984	545	3.3	724	1 269	7.4
1985	1 257	7.2	791	2 047	11.4
1986	828	4.4	891	1 719	9.1

Table 3.2
EVOLUTION OF TAX BURDEN DIFFERENTIAL
ECONOMIC AGENTS IN PRIVATE SECTOR
QUÉBEC STRUCTURE COMPARED WITH ONTARIO STRUCTURE

	Individuals		Business firms		Economic agents in private sector	
	$M	%	$M	%	$M	%
1977	1 093	20.0	14	0.6	1 107	14.0
1978	943	16.1	49	1.8	992	11.5
1979	896	13.7	– 98	– 3.2	798	8.3
1980	688	9.1	31	0.9	719	6.6
1981	726	8.4	284	7.5	1 011	8.2
1982	1 422	15.0	584	15.4	2 006	15.1
1983	1 042	10.0	292	7.0	1 334	9.1
1984	535	4.6	10	0.2	545	3.3
1985	1 259	10.3	– 2	0.0	1 257	7.2
1986	949	7.2	–121	– 2.2	828	4.4

N.B.: This table was used to compose Graphs 3.1, 3.2 and 3.3.

Table 3.3
EVOLUTION OF AVERAGE TAXATION RATES[1]
COUPLE WITH TWO CHILDREN (6-11 YRS.)
AVERAGE FAMILY INCOME
(as a percentage of average family income)

Year	Average family income	Provincial rate in Québec	Federal rate with abatement	Federal-provincial rate in Québec	Federal-provincial rate in Ontario
1972	10 384	8.69	8.37	17.06	18.03
1973	12 024	9.47	8.32	17.79	17.43
1974	13 742	10.38	7.90	18.28	17.08
1975	15 446	10.16	7.86	18.02	17.15
1976	18 219	11.90	8.65	20.55	18.68
1977	19 056	12.42	7.66	20.08	17.66
1978	21 203	11.94	6.73	18.67	16.95
1979	23 400	12.97	7.80	20.77	18.03
1980	25 389	12.79	7.78	20.57	17.92
1981	28 124	13.09	7.91	21.00	18.34
1982	30 509	13.49	6.90	20.39	17.52
1983	31 937	13.35	7.90	20.44	17.86
1984	34 045	13.66	7.67	21.33	18.76
1985	35 066	13.93	8.20	22.13	18.84
1986[2]	36 469	12.66	9.48	22.14	20.56

(1) Taxes net of Québec and federal family allowances and federal child tax credit.
(2) The 1986 rates reflect the impact of the February 1986 federal budget.

Table 3.4
COMPARATIVE EVOLUTION OF MAXIMUM MARGINAL PERSONAL INCOME TAXATION RATES
QUÉBEC-ONTARIO
(as a percentage of taxable income)

	Québec	Ontario	Spread
1976	63.7	61.3	2.4
1977	63.9	61.9	2.0
1978	68.9	61.9	7.0
1979	68.9	61.9	7.0
1980	68.4	61.9	6.5
1981	67.9	62.8	5.1
1982	60.4	50.3	10.1
1983	60.4	50.7	9.7
1984	60.4	51.1	9.3
1985	62.1	52.0	10.1
1986	59.5	55.4	4.1

1 The 1986 rates reflect the impact of the February 1986 federal budget.

APPENDIX 4

Additional information on federal transfers

(A) Québec's position with regard to the fiscal arrangements

An incomplete equalization program

It must be said that the new equalization formula introduced in 1982 has only succeeded in increasing the difference in fiscal capacity between Ontario and Québec. For example, whereas in 1979-1980 and 1980-1981 Québec had fiscal parity with Ontario, under the new formula instituted in 1982 it is able to obtain only 94.3 % of Ontario's capacity in 1985-1986. If Québec were to remain in a position of parity with Ontario, in 1985-1986 it would have to receive an additional $1.2 billion in equalization payments. It can be seen from this example that the changes in equalization payments have much to do with Québec's present financial difficulties.

Moreover, the equalization program, which assures a certain degree of equalization of the provinces' capacity to offer public services, implies that per capita public service needs are the same throughout Canada. If such a theory is acceptable with regard to health and post-secondary education expenditures, surely it should not be acceptable for income security programs, shared by the federal government, as well[1]. Of the ten Canadian provinces Québec has the heaviest burden under this expenditure item. This phenomenon stems mainly from long unemployment periods, so that the probability of a person turning to social aid is greater in Québec than in any other province.

Table 4.1
PER CAPITA PROVINCIAL EXPENDITURE FOR INCOME SECURITY SHARED BY THE FEDERAL GOVERNMENT UNDER CAP (1985-1986)

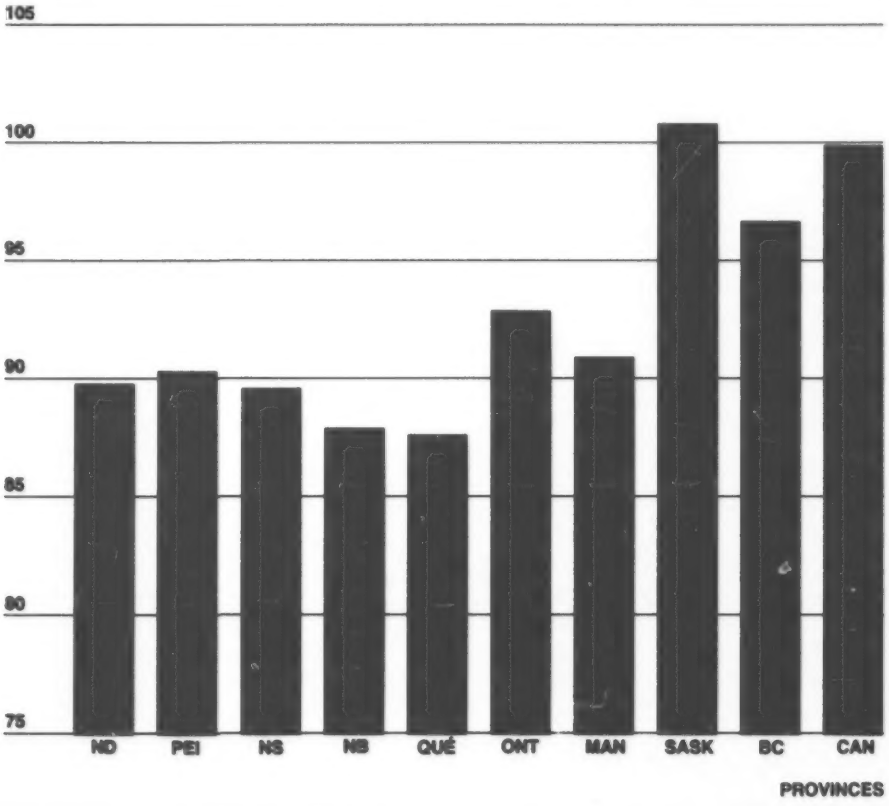
	$	National average = 100	Average for five provinces = 100[1]
Newfoundland	189	74	71
Prince Edward Island	196	77	74
Nova Scotia	187	73	71
New Brunswick	313	123	118
Québec	372	146	140
Ontario	178	70	67
Manitoba	167	66	63
Saskatchewan	197	77	74
Alberta	203	79	76
British Columbia	356	139	134
Five provinces[1]	265	104	100
Canada	255	100	96

1 These five provinces are used to define the norm: Québec, Ontario, Manitoba, Saskatchewan and British Columbia.

1 Social aid, legal aid, health assistance, and the administration of these programs.

Even though the federal government pays 50 % of the costs of the Canada Assistance Program (CAP), the remaining burden for Québec is more difficult to support, per capita, than in the other provinces. For instance, an interprovincial comparison shows that, if the tax burden is standardized and federal transfers are included in revenue as equalization, the financing of established programs and the CAP, Québec has the lowest capacity for offering public services, once income security costs are assured.

Graph 4.1
CAPACITY OF THE PROVINCES TO PROVIDE PUBLIC SERVICES OTHER THAN INCOME SECURITY (1985-1986)
(Canada = 100)



Note: Alberta was not included in the graph to better illustrate the discrepancies between the other provinces (Alberta has an index of capacity of 179.7).

This situation is the result of shortcomings in the equalization program as well as of the inadequacy of federal funding for provincial income security programs. It means that once its income security costs are guaranteed, Québec must either consent to an increase in its tax burden or its debt, or reduce the number and quality of other public services. This amounts to an inequity in the system of transfers to the provinces which should be corrected by an adequate equalization mechanism, while the cuts stemming from Bill C-96 will only exacerbate interprovincial disparities since the federal government is once again using a mechanical approach.

The federal transfer mechanism

The mechanism of the transfer system limits the financial leeway of the provinces, especially of those benefiting from equalization, for implementing regional economic development policies. In Québec's case, present estimates indicate that over 50 % of any increase in own-source revenue through growth in the province's relative wealth is cancelled out through the automatic reduction of federal transfers.

In effect, such an increase means:

— a reduction in equalization payments to Québec;

— an increase in the value of the federal tax base in Québec which entails a reduction of transfers for the EPF and CAP. Cash payment for these two programs are calculated by deducting from the total federal contribution the value of the tax field assigned to Québec in 1965 and in 1967 for financing post-secondary education. More than 28 federal tax points were in this way added to the Québec tax structure;

— an additional reduction in equalization transfers through a tax transfer of 3 tax points made in 1964 to finance the youth allowances program (not in effect today), which is now part of the equalization payment reduction plan.

The result is that a sizable portion of Québec's economic development efforts do not benefit it due to a reduction in federal government expenditures for transfers. This situation, although normal in a federation that ensures a partial redistribution of wealth through equalization, can only discourage development efforts. The federal government could remedy this situation by increasing, for example, its relative financial contribution to economic development programs in the poorer provinces.

Québec's demands

Even failing improvement in its economic situation, Quebec's federal financial transfer revenue will drop because of the cuts provided for in Bill C-96. In addition, if Québec's economic growth were greater than that of the other provinces, the cuts would only be increased. This is a " poverty trap ".

This is the reason for Québec's request that the federal governement not proceed with these " blind " cuts, but that it take interprovincial disparities into account when making changes in the methods of calculating transfers to the provinces. Certain principles should be respected under this heading: first, the equalization program should be revised to bring the fiscal capacity of Québec and the other recipient provinces more into line with that of Ontario; second, the financing formula for income security programs should be amended to relieve certain provinces of a tax burden that is relatively heavier than elsewhere; finally, the federal government should permit greater flexibility in the management of provincial programs giving rise to transfers under EPF. Bill C-96 should be modified in this respect.

As concerns the present mechanism for transfers to the provinces, it is imperative that the federal government change a situation that can only discourage every effort to develop economically.

(B) Impact of cuts in EPF 1982-1987 and 1987-1992

IMPACT OF CUTS IN EPF[1]
QUÉBEC
(in millions of dollars)

	1982-83	1983-84	1984-85	1985-86	1986-87	Total 1982-87
Cuts made by previous federal government						
Withdrawal of revenue guarantee payments (1982-1983)	−218.4	−239.9	−260.9	−278.9	−300.3	−1 298.4
6 % and 5 % (1983-1984 and 1984-1985)	—	− 32.8	− 69.4	− 74.2	− 79.9	− 256.2
Bill C-3 (1983-1984)	—	—	− 7.9	− 6.1	—	− 14.0
Total	**−218.4**	**−272.7**	**−338.2**	**−359.2**	**−380.2**	**−1 568.6**
Cuts planned by the Conservative government						
Bill C-96 (1986-1987)	—	—	—	—	− 82.3	− 82.3
Total cuts						
Revenue guarantee payments, 6 % and 5 %, Bill C-3, C-96	**−218.4**	**−272.7**	**−338.2**	**−359.2**	**−462.5**	**−1 650.9**

IMPACT OF CUTS IN EPF (cont'd)
QUÉBEC
(in millions of dollars)

	1987-88	1988-89	1989-90	1990-91	1991-92	Total 1987-92	Total 1982-92
Cuts made by previous federal government							
Withdrawal of revenue guarantee payments (1982-83)	−320.9	−341.4	−362.2	−384.8	− 408.8	−1 818.0	−3 116.4
6 and 5 % (1983-84 and 1984-85)	− 85.3	− 90.8	− 96.3	−102.3	− 108.7	− 483.4	− 739.7
Bill C-3 (1983-84)	—	—	—	—	—	—	− 14.0
Total	**−406.2**	**−432.2**	**−458.5**	**−487.1**	**− 517.5**	**−2 301.4**	**−3 870.1**
Cuts planned by the Conservative government							
Bill C-96 (1986-87)	−174.9	−277.2	−389.2	−512.4	− 647.6	−2 001.3	−2 083.6
Total cuts							
Revenue guarantee payments, 6 % and 5 %, Bill C-3 Bill C-96 (1986-1987)	**−581.1**	**−709.4**	**−847.7**	**−999.5**	**−1 165.1**	**−4 302.7**	**−5 953.7**

1 Established program financing: health and post-secondary education.

APPENDIX 5

The reform of 1978 concerning accounting procedures for public sector retirement plans

Québec government employees and those in the education, health and social services networks participate in three public sector retirement plans. The Government and Public Employees Retirement Plan (RREGOP) came into effect on July 1, 1973, the date on which the Civil Service Superannuation Plan (CSSP) and the Teachers Pension Plan (TPP) ceased to accept new members. Members of the National Assembly, judges and coroners, and members of the Sûreté du Québec have their own retirement plans whose financing is, in varying degrees, the responsibility of the government.

Up to 1978-1979, the government's financial commitments towards retirement plans varied from one plan to the next. In order to bring more harmony into the handling of these plans and to enter the government's commitments with regard to them in the books in a more complete, better-adapted manner, an accounting reform of the transactions carried out under these plans was undertaken to begin during that fiscal year and to be applied gradually.

Before 1978-1979, for plans other than RREGOP, employee contributions to retirement plans were entered as government revenue while retirement benefits paid out were entered under expenditure. Since the reform, no record concerning the retirement plans has appeared under budgetary revenue, while the government's contribution is now entered under expenditure. This can be divided into three categories:

- There is, first of all, a contribution for current service, that is to say, an amount to pay pensions earned by participants during the fiscal year in progress. In 1985-1986, this contribution amounts to some $488 million for all plans.
- Second, there is a contribution for past service, an amount to cover pensions earned by participants in previous years, and for which the government had not entered its contribution for current service. The actuarial deficiencies of the retirement plans, or the government's unrecorded commitments, represent the present value of benefits that will have to be paid to contributors for whom no reserve has been constituted. A considerable commitment had accumulated in this respect for plans other than RREGOP for the period preceding the reform of 1978. As of 1979-1980, the government introduced a 50-year amortization policy for actuarial deficiencies. Since annual payments of this kind are made in terms of the total payroll of participants. This amortization formula, which provides for growth for the period of the unrecorded commitments, then their rapid reabsorption so that they are completely written off and entered under liabilities at the end of the 50th year, was an adequate solution to the problem considering the advanced age of the plans in question at the time it was implemented. Unrecorded commitments stood at $12.6 billion as at March 31, 1985, and, for 1985-1986, the government contribution posted to expenditure for amortizing the actuarial deficiencies is $360 million.
- Thirdly, a contribution in interest has been recorded yearly since 1978-1979 on the balance of the provision for retirement plans which appears under government liabilities. Whereas employee contributions to RREGOP are paid into a special fund at the Caisse de dépôt et placement du Québec, other employee and employer contributions are entered in a non-budgetary account integrated into the government's financial transactions; the sums required for the payment of the corresponding benefits are taken from this account. Since the non-budgetary account for the retirement plans is realizing a surplus at the moment, the present accounting procedure has the effect of reducing the government's external financing requirements. In other words, every year the government borrows, implicitly, the surplus of this non-budgetary account by entering it under its liabilities; consequently, it must pay the interest on the accumulated balance. In 1985-1986, the contribution in interest is $708 million for all plans.

The following table shows the evolution of government expenditure for retirement plans since 1979-1980, the year in which all parts of the reform of the accounting procedure were put into effect.

Table 5.1
CONTRIBUTIONS TO RETIREMENT PLANS
1979-1980 to 1985-1986
(In millions of dollars)

	1979-1980	1980-1981	1981-1982	1982-1983	1983-1984	1984-1985	1985-1986
Current service	473.0	558.1	613.4	540.8	474.2	481.8	487.8
Past service	172.0	172.7	224.3	246.5	278.4	337.0	360.3
Interest on balance of account	87.6	164.6	263.4	379.5	480.3	597.8	707.9
Total contributions to retirement plans	732.6	895.4	1 101.1	1 166.8	1 232.9	1 416.6	1 556.0

The changes brought about as a result of this reform of the accounting procedure for retirement plan operations, which have no effect on net financial requirements, have meant that the government's budgetary deficit is, in total, close to $1 billion higher in 1985-1986 than it would have been without the changes. The following table shows the effects of these changes on the government's budgetary deficit.

Table 5.2
EFFECT OF MODIFICATIONS IN ACCOUNTING OF RETIREMENT PLAN TRANSACTIONS
1979-1980 to 1985-1986
(in millions of dollars)

	1979-1980	1980-1981	1981-1982	1982-1983	1983-1984	1984-1985	1985-1986
Budgetary revenue							
• Before modifications[1]	+148.5	+151.3	+ 170.4	+ 193.7	+ 183.0	+ 175.3	+ 171.9
• Effect of modifications[1]	−148.5	−151.3	− 170.4	− 193.7	− 183.0	− 175.3	− 171.9
	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Budgetary expenditure							
• Before modifications							
— Current service							
— RREGOP	−304.1	−388.5	− 418.6	− 353.9	− 302.2	− 314.7	− 321.1
— Benefits[2]	−176.5	−203.7	− 238.4	− 287.9	− 340.2	− 389.6	− 436.4
	−480.6	−592.2	− 657.0	− 641.8	− 642.4	− 704.3	− 757.5
• Effect of modifications							
— Current service							
— Other plans	−168.9	−169.6	− 194.9	− 186.9	− 172.0	− 167.1	− 166.7
— Past service							
— Other plans	−172.0	−172.7	− 224.3	− 246.5	− 278.4	− 337.0	− 360.3
— Interest	− 87.6	−164.6	− 263.3	− 379.5	− 480.3	− 597.8	− 707.9
— Benefits	+176.5	+203.7	+ 238.4	+ 287.9	+ 340.2	+ 389.6	+ 436.4
	−252.0	−303.2	− 444.1	− 525.0	− 590.5	− 712.3	− 798.5
• Total government contribution to retirement plans after modifications	−732.6	−895.4	−1 101.1	−1 166.8	−1 232.9	−1 416.6	−1 556.0
Effect of modifications on deficit	**−400.5**	**−454.5**	**− 614.5**	**− 718.7**	**− 773.5**	**− 887.6**	**− 970.4**

N.B.: A (−) sign indicates a financial requirement and a (+) sign, a source of financing.

1 Includes contributions from autonomous agencies and from employees contributing to retirement plans other than RREGOP. Employee contributions to RREGOP are paid directly into the Caisse de dépôt et placement du Québec.

2 Include the portion of the benefits under RREGOP for which the government is responsible and all the benefits paid under other plans.